DOCTOR OF PHILOSOPHY

"Quota Measures" and "Trade-Related Investment Measures" in Oil and Gas Regulation
Reconciling Normative Conflicts between Energy-focused Regimes and WTO Rules on Energy

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'Quota Measures' and 'Trade-Related Investment Measures' in Oil and Gas Regulation: Reconciling Normative Conflicts Between Energy-Focused Regimes and WTO Rules On Energy

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CONTENT

CHAPTER THREE

PART 2
BORDER MEASURES AND TRIMS IN PRACTICE IN THE OIL AND GAS SECTORS

CHAPTER FOUR

TABLE OF CASES

WTO Cases

Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and other Items, panel report circulated 25 November 1997, adopted 25 November 1997, WT/DS56/R

Argentina–Measures Affecting the Export of Bovine Hides and the Import of Finished Leather , Report of the panel adopted December 19, 2000, WT/DS155/R

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Canada – Certain Measures Affecting the Automotive Industry, Appellate Body Report, 31 May 2000 WT/DS142/AB/R

Canada — Wheat Exports and Grain Imports Appellate Body Report, adopted 30 August 2004WT/DS276/AB/R,

Canada- Certain Measures Affecting The Renewable Energy Generation Sector, Appellate Body, 19 December 2012, WT/DS412/R, WT/DS426/R

Canada- Measures Affecting the Importation of Milk and the Exportation of Diary Products, Appellate Body Report, adopted on January 17, 2005, WT/DS103/AB/R W2,

China- Measures Related to the Exportation of Various Raw Materials Report of the panel, 5 July 2011, WT/DS394/R, WT/DS395/R, and WT/DS398/R; Appellate Body, 30 January, 2012.

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EEC – Regulation on Imports of Parts and Components adopted 16 May 1990, l/6657 – 37S/132

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India – Quantitative restrictions on Imports of Agricultural, Textile and Industrial Products, Appellate Body report circulated 23 August 1999, adopted 22 September 1999, WT/DS90/AB/R

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Japan – Measures on Imports of Leather, panel report adopted 15/16 May 1984, BISD 31S/94

Japan – Taxes on Alcoholic Beverages II, Appellate Body report circulated 4 October 1996, adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R

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Korea – Measures Affecting Government Procurement, Report of the Panel adopted May, 2000, WT/DS163/R

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Compagnie Maritime Belge Transports v Commission (Case C-396/96 P) [2000] ECR I-1365 at 34; citing Case 322/81 NV Nederlandsche Banden-Industrie Michelin v Commission (Michelin I) [1983] ECR 3461
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ICSID Decisions

Noble Ventures, Inc. v. *Romania*, Award, ICSID Case No. ARB/01/11, para. 69 (Oct. 12, 2005)

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DECLARATION

I, **Ernest Oseremen Enobun** am the sole author of this thesis; that, unless otherwise stated, all references cited have been consulted by me; that the work of which the thesis is a record has been done by me, and that it has not been previously accepted for a higher degree.

Signature:……………………………………Date………………………………………….

STATEMENT

This is to certify that Ernest Oseremen Enobun conducted his research under my supervision and has fulfilled the conditions of the relevant ordinances and regulations

Signed………………………………………….. Date……………………………………….
Mr. Stephen Dow

LIST OF ABBREVIATIONS

OPEC	Organisation of Petroleum Exporting Countries
WTO	World Trade Organisation
PSNR	Permanent Sovereignty over Natural Resources
ECT	Energy Charter Treaty
UNGA Res	United Nations General Assembly Resolution
GATT	General Agreement on the Tariff and Trade
UNCTAD	United Nations Centre for Trade and Development
ICJ	International Court of Justice
LCR	Local Content Requirement
TRIMs	Trade-related Investment Measures
TFEU	Treaty on the Functioning of the European Union
NOC	National Oil Companies
IOC	International Oil Companies
LNG	Liquefied Natural Gas
NAFTA	North American Free Trade Agreement
PSC	Production Sharing Contract
STE	State Trading Enterprise
GATS	General Agreement on Trade in Services
ICSID	Convention on the Settlement of International Dispute
CERDS	Charter of Economic Rights and Duties of States
ICTSD	International Centre for Trade and Sustainable Development
OECD	Organisation for Economic Cooperation and Development
NATO	North Atlantic Treaty Organisation
IPA	International Petroleum Agreement
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding

ABSTRACT

Regulation of border and behind-the-border measures in the oil and gas sectors presents the 'resource access' challenge with immense economic ramifications for export markets, yet their status under the multilateral trading regime remains obscure. Recent developments that could reshape the trading regime and market dynamics for oil and gas have seen the call for a global energy governance gain momentum in recent years. But the complex relationships between national laws, institutional norms, and the multilateral trading regime regulating energy presents an ideological 'conflict in applicable law'. They reveal a conflict between regulatory privileges enshrined in energy resource-focused institutions namely: OPEC as a producer-only treaty, the ECT as a sector-specific multilateral energy treaty, national energy laws on the heel of the PSNR principle as a customary international law; and international obligations under the GATT rules relevant to energy. These regimes have the trappings of nationalism, regionalism, and institutionalism in energy regulation, thereby creating an ambiguous path to global energy governance. This research revisits the institutional and regulatory architecture of oil and gas regimes from the perspective of quota measures and trade-related investment measures (TRIMs) implemented through the instrumentality of national laws, acts of NOCs (in the oil sector) and acts of non-state undertakings (in the gas sector). It therefore charts an uncommon territory and brings a new dimension to the discipline of energy and trade, with a robust examination of how regulation of quota measures and trade-related investment in the oil sector (with export restriction issues) differs from their regulation in the gas sector (with underlying competition issues) and how their varying trade effects shape their future in international economic law. Given the inherent conflicts between the legal, policy, and regulatory design of these regimes governing energy, this research first explores and applies the principle of conflict of norms to energy governance. This paves way for a hands-on approach to examining the applications of these measures under the auspices of these regimes aimed at a 'co-operative energy governance' between the resource-focused regimes and the GATT rules relevant to energy on the basis of their trade effects. I argue that an understanding of 'quota measures' and 'TRIMs' in the oil sector compared to their implementations in the gas sector is compelling in making a case for a systemic energy cooperation that would serve economic interests of all affected states without diminishing the normative value of each regime in each sector.

INTRODUCTION

1.1 Research Background

The international regulation of trade and investment in energy[1] between national laws, institutional norms, and the multilateral trading regime remains a contentious area in international economic law discipline. Being that oil and gas as primary goods go into the production of virtually all manufactured goods essential for any thriving economy, the political economy of oil and natural gas is characteristically shrouded in geopolitical tensions with global economic ramifications. Besides other notorious exogenous factors that disrupt the normal flow of demand and supply of oil and gas such as crisis in the Middle East; natural disasters; pipeline vandalisms and environmental disasters in producing countries, this research examines the crucial role of Regulation in the form of '*border measures*' and '*trade-related investment measures*' (TRIMs). The case is made here that producing states' affiliation to energy-focused institutions largely define their policies both at the border and behind the border, which in turn have a ripple effect on resource access in export markets and investment decisions of foreign investors (or new entrants to networks in the case of the internal gas market).

Tellingly, in spite of their trade-distorting outcomes (trade effects), the WTO as the forum for international trade in goods and services still grapples with quota (or border) measures and TRIMs in the oil and natural gas sectors. It is common knowledge that

[1] While 'energy' in some parlance may mean 'electricity' as a secondary product, this research deals with crude oil and natural gas resources specifically as primary products. For that purpose, I generically refer to them as 'energy resources' rather than just 'energy'.

export restrictions in oil and gas continue to thrive regardless of the free trade principles of the WTO discipline.[2] Understandably, there was the notion that the General Agreement on Tariffs and Trade (GATT) was designed to promote *market access* for foreign products by tackling import barriers, which explains why it is mute on promoting *resource access*.[3] And since access to energy resources would flourish on the removal of export barriers, the GATT's lack of textual content on 'resource access' explains the WTO's seemingly weak competence in governing border measures and TRIMs which are essentially export barriers. [4]

Nonetheless, subsequent literatures have debunked this notion and it is now widely accepted by trade lawyers that energy trade is covered by the WTO rules,[5] particularly on the basis of Article XI:1 GATT.[6] But while this is true in theory, such ancillary

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[2] Desta, M.G., 'The Organization of Petroleum Exporting Countries, the World Trade Organization, and Regional Trade Agreement', *JWT.* 2003; 37 (3) 532 – 538

[3] Re-echoed in Desta, M.G., *ibid.* Unlike the '*market access*' challenge which focuses on removing import restriction of foreign goods in their export markets designed to protect domestic production in those markets, the '*resource access*' challenge relates to restriction of export in natural resources to markets on the basis of environmental protection, and on the grounds that unrestricted exports under-serves domestic consumption, leads to oversupply, which drives down cost and ultimately hurts producing economies. This then creates a situation where demand for resources outpaces supply.

[4] Reference to 'exports' or 'exportation' is astonishingly limited in the entire GATT text. The only reference to exports are found in Articles I:1 and Article XI:1 and 2, Article XX, and Article XVI which even though is about 'export subsidy', purports to dissuade states from employing such measures. Essentially, the preponderance of its substantive issues are focused on the removal of import barriers to enhance market access for foreign products and to ensure national treatment for imported goods.

[5] Cottier, T., *et al* 'Energy in WTO Law and Policy', *supra;* Selivanova, Y., '*The WTO and Energy: WTO Rules and Agreement relevant to the energy sector*', ICTSD 2007; *World Trade Report 2010;* UNCTAD 2000 'Trade Agreements, Petroleum and Energy Policies' at page 65. See also Selivanova, Y., *Trade in Energy: Challenges for International Trade Regulation'* at http://www.wto.org/english/res_e/publications_e/wtr10_forum_e/wtr10_11june10_e.htm; Desta, M.,'OPEC Production management practices under WTO Law and the Antitrust Law of Non-OPEC Countries', in *Journal of Energy and Natural Resources Law* Vol. 28 No.4 (2010).

[6] Article XI:1 GATT (general elimination of quantitative restriction) which embodies one of the fundamental principles of the GATT prohibits any measure except duties, taxes or charges, that restricts the importation "or the exportation or sale for export of any product destined for the territory of any other contracting party". The interpretative meaning of the underlined is that the disciplines of the WTO Agreements are applicable to exports of every product as it is with imports – and by extension, applicable to export-related measures in the natural resource sector. Reference may also be made to Article XIII which relates to the administration of restrictions authorized under Article XX that are generally prohibited under Article XI.

application is rather simplistic considering the ideological, geopolitical, trans-border, and environmental intrigues surrounding hydrocarbons. Therefore, to say that the GATT 'applies to energy' simpliciter is not analogous to the GATT being 'well equipped' to tackle energy-related issues.[7] The underlying assumptions of GATT's extended coverage to energy are noticeably undermined in the oil and gas sectors due to factors such as their physical characteristics compared to other goods, the political sensitivity they attract, the regionalism that characterises gas trade, and the environmental questions surrounding oil. In the light of these peculiarities, notwithstanding WTO's coverage on energy, there is still very limited literature on 'resource access',[8] and this research identifies border measures and TRIMs as key constituents of the resource access challenge.

As an observation, though the 'resource access' challenge is mainly rife in the oil sector particularly in relation to access to crude at the wellhead point prompting security of supply concerns,[9] the larger part of the gas sector, and in some cases - oil via pipelines, is however faced with 'market access' challenges.[10] For instance, access to transmission networks leading to markets and uncertainty in networks due to changes in market demand forces, e.g., weather conditions – ultimately prompting security of demand

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7 Selivanova, Y., '*The WTO and Energy: WTO Rules and Agreement relevant to the energy sector*', ICTSD 2007; Ruhl, Christof, '*Global Energy after the crisis: Prospects and Priorities, 2010.* Foreign Affairs, 89 (2), 63-73.

8 Even a literature on energy trade and investment still voices the perception that only rules on market access for foreign goods and national treatment for imported goods are "conceivable" rules in trade and investment law. See Albath Lars, *Trade and Energy: Investment in the Gas and Electricity Sectors* (Cameron May, London, 2004) at 42.

9 Currently, fossil energy (oil, gas and coal) accounts for 82% of energy trade, with oil exports being the highest at 34% and projected to be the leading fuel up till over 2020; natural gas at 21.4%, and coal at 27.3%. See Report of the IEA 2012, 51. See also OPEC 'World Oil Outlook 2012'. But with the world oil demand projected to increase by 87% in developing Asia by 2035 following its industrial revolution, pressure will continue to mount on oil production, and a cut in production will certainly cause price shocks (See generally OPEC 'World Oil Outlook 2012'. pp 46 and 58).

10 Although some resource access challenges exist in gas trade, e.g., The problem of access to spot LNG and security of supply concerns in cross border pipeline gas (bulk transfers) from a gas exporting country to another, the challenge of market entry is rife in the European internal gas market.

concerns for suppliers.[11] What this reveals is that in addition to its limited focus on 'resource access', the WTO – in spite of its 'market access' credentials, does not appear to be in sync with the 'market access' issues peculiar to the gas sector. It therefore comes as no surprise that while states engage in trade as a global community on the free trade principles of reciprocity, we hear of states with stakes in oil and gas resources, whether as net consumers; transit countries; or net exporters, crafting and scaling up their own energy policies. Accordingly, certain multipolar and nationalistic interest groups have emerged across the energy spectrum, especially at regional levels, to facilitate border measures and TRIMs in these sectors; all aimed at furnishing their interests.[12]

This research approaches energy trade regulation from two perspectives. *First*, from the angle of border measures and TRIMs in the oil sector *vis-à-vis* border measures and TRIMs in the gas sector, implemented by states from three divergent economic blocs, namely: **export-only developing countries**, **exporting/importing emerging market economies**, and **import-only developed countries**, and *secondly*, from the angle of the legal characters of institutional norms by way of treaty affiliation from which each of these economic blocs derive their energy-focused policies. This framework ultimately

[11] Just because there is demand for gas does not mean there is a market. The 'market access' problem in gas pertains to network barriers between production and demand point, leading to lack of markets for gas in spite of demand. Stranded gas due to problems with off-take arrangements, pricing mechanisms downstream etc., are examples of market access issues. See generally, Arthur S. De Vany and David Walls W., *The Emerging New Order in Natural Gas: Markets versus Regulation* (Westport Connecticut, Praeger, 1995).
[12] Consumer interest groups include: the *North American Free Trade Agreement* (NAFTA) which has a section of energy policy, the *Asia-Pacific Cooperation* (APEC) comprising of major consumers in the Asia-Pacific, and the *International Energy Agency* (IEA) comprising of net importers across the West. A more comprehensive group is the *Energy Charter Treaty* (ECT) focused on supply security, investment protection, and facilitation of energy transit. Then there is the broader regional interest group: Association of South East Asia Nations (ASEAN) and *Economic Community of West African States* (ECOWAS). And lastly, there is the producer-only group with plurilateral agreement among its members: The *Organization of Petroleum Exporting Countries* (OPEC); and the global regime that recognises the rights of all resource producers: *The UN Resolution on Permanent Sovereignty over natural resources.*

constitutes the institutional architecture and regulatory systems in the oil *vis-à-vis* the gas sector which this research is focused on. It therefore explores the intricacies of border measures and TRIMs within these regimes, their trade effects in both the oil sector and the gas sector, and examines their implications as well as potential in-roads for the WTO in energy governance.

<u>*Border measures and TRIMs in the Oil and Gas Sectors*</u>

THE OIL SECTOR: Chapter four captures the relevant border measures (*production restriction,* and *export ban*) and TRIMs (*performance requirement such as local content requirement)* as well as their trade effects. It also raises the question of whether *acreage allocation* and *production sharing contracts (PSCs)* possess characteristics of TRIMs as described by the TRIMs Agreement and GATT Article III:4 since they impose stringent requirements on foreign investors such that they are given less favourable treatment compared to local competitors.

THE GAS SECTOR: Examining these measures in the gas sector is more complex given the duality of market access and resource access challenges present. In the light of this, Chapter five explores access to gas pipeline market and access to natural gas commodity under the tenets of a plausible relationship between trade law and competition law. We will see that while access to networks constitute the current gas market challenge, regulation of access to networks which is designed to promote competition could also undermine competition, ultimately bringing volume risks into the mix with attendant effects on commodity markets (export volume). A series of network bureaucracies and volume risk depends on the stage it is at the gas value chain- i.e., production, generation, transmission, conversion, storage, distribution, utilization, and consumption.[13] Resource access on the other hand relates to restrictions of gas exports to regions. For example, Russian gas cut to Western Europe during the South Ossetia conflict, US ban on LNG export to non-NAFTA countries, as well as disruptive measures by transit states.

Historical background to restrictive trade measures in the Oil and Gas sector

Prior to the GATT of 1947, with the outbreak of WW1 and WW2 access to food and raw materials were issues of national security, prompting government interventions in mounting protectionist barriers to trade.[14] Post WW2, borders began to open up following negotiation of the GATT 1947. Although energy was gaining prominence in global economic relationships, it was excluded from negotiations – the need simply did not particularly arise.[15] This coincided with the fact that at the time, the US was at the time a net exporter of oil. Being a central player in the 1947 GATT negotiations, the exclusion of energy was convenient for the US to avoid trade bureaucracies in oil.[16]

Control in energy resources was with developed countries as most developing countries where most of the world's hydrocarbons were situate (and who are currently OPEC member states) had not gained independence at the time, let alone implement any

[13] Since this study focuses on the trade aspects of oil and gas, it limits itself to the issues prevalent upstream to midstream. (i.e., production, generation, and transmission).

[14] See World Trade Report, 2012. p. 64.

[15] This intentional omission has proved to be costly under the current international economic order. UNCTAD had observed that even the general exception provisions in GATT Article XX (g) reflected the wide gap between the petroleum sector and the multilateral trading system up until 1990. It stated thus: "*[the general exception] had served to strengthen the perception that, in general, international trade in crude petroleum was excluded from the rules on the multilateral trading system, and was governed by its own distinctive rules. It was only when petroleum-producing and exporting countries such as Mexico (1986) and Venezuela (1990) negotiated their accession to GATT that the issue of flexibility for the management of crude-oil export policies came to the fore*." See *ibid* at 23

[16] See Yergin, D., *The Prize: The Epic Quest for Oil, Money and Power* (London: Simon & Schuster, 1991), p.410

protectionist measures.[17] For those who had gained their independence before then, some had not discovered commercial quantity at the time,[18] while others such as Iraq, Venezuela, Ecuador where commercial oil had been discovered arguably lacked the human, technological, and political capital to manage their resources.

The early 1960s ushered in a transition from colonisation to independence in the rest of developing producing countries. However, resource management still remained in the hands of foreign companies as they had the expertise. So the need to feature hydrocarbons in the GATT negotiations still did not arise.[19]

The 1970s saw another transitional era renowned for changing the global oil and gas landscape. This era was marked with the transfer of technological and management expertise from IOCs to host governments. A distinctive feature of this era was the creation of national oil companies (NOCs) to serve as vehicles through which States facilitated the transitions. By late 1970s, the wind of resource nationalism, expropriation, and control by national oil companies had swept across the oil and gas world.[20] This era

[17] Libya, Nigeria, Algeria, Kuwait, Angola, and the UAE.

[18] Of the 23 first signatory States to the GATT, there were 10 leading developing countries and none of them were major energy resource exporters at the time. They were Brazil, China, Pakistan, Burma, Ceylon, Chile, Cuba, India, Syria, and Lebanon. Of these 10, China, India, and Brazil who are currently major resource exporting countries implementing export restrictions had just got their independence at the time of the GATT 1947 and were not at the time known for their natural resource endowment. They also did not have the status of emerging economies to be taken seriously at the world stage.

[19]See Jimenez-Guerra '*The world trade organisation and oil*' (2000) at 13-27 for a historical account of the transition of the GATT from its era of exclusion of hydrocarbons to its recognition of hydrocarbons.

[20]Saudi Arabia's oil was under the control of the Arabian American Oil Company (ARAMCO)- an international oil company from 1943. The Saudi Arabian government bought over ARAMCO in 1988; Following the first successful oil discovery in Iran in Masjid Suleiman-1 on May 26, 1908, the Anglo-Persian Oil Company (A British Company) and the National Iranian Oil Company (NIOC) only took control of Iranian oil industry in 1979 and established the Iranian Buyback Contracts where the NIOC reimburses foreign investors for production expenses while it retains ownership of the oil fields; Following discovery in Baba Gurgur in Iraq on 14 October, 1927, the Iraq Petroleum Company largely of British origin took control of Iraq's oil industry until 1972 when the Iraq National Oil Company (INOC) took control; Following oil discovery in Burgan Kuwait on February 22, 1938, British Petroleum and Gulf took control of Kuwaiti oil

ushered in the new international economic order (NIEO) preceded by the growing influence of OPEC's production restriction which began with the oil embargo in 1973 by the Arab league of oil producing countries that led to first oil price shock. Today, while increase in non-OPEC production is again changing the oil landscape, the primacy of OPEC remains crucial to security of energy supply.[21]

The 1990s witnessed yet again another significant era. Developing producing countries began to negotiate their accession to the WTO. Today, as at the time of this research, except Iraq, Iran, and Libya, all the other OPEC countries have gained accession to the WTO. By implication, the legality of their protectionist border measures and TRIMs in the oil and gas sector came under international scrutiny on the basis of their being arguably in conflict with their obligations under the GATT and the TRIMs Agreement.[22]

The foundation for this scrutiny is that by accession, they adopted the supranational principles of free trade in all other goods and services, including oil and gas. Since new disciplines such as trade in services, which also applies to trade in energy services was incorporated in the Uruguay Rounds of Negotiations that saw the birth of the GATT of 1994 and the WTO, it indicates that multilateral trade rules under the GATT/WTO of 1994 can play a more significant role in regulating international trade in energy than the

production. The Kuwait Oil Company took over control in 1975. While petroleum was discovered in Venezuela in 1914, Venezuela took control of its oil industry in 1976 following the establishment of Petroleos de Venezuela SA (PDVSA).

[21] As at 2013 non-OPEC countries accounts for 19% of world crude oil while OPEC countries account for 81% of world crude oil production. See http://www.opec.org/opec_web/en/data_graphs/330.htm. Last visited January 2014.

[22] America's attempt at suing OPEC before the WTO. *infra*

GATT 1947.[23] Yet attempts at an open market system for trade in oil and the reciprocity regime in natural gas have so far been implausible.[24] While having unrestricted access to oil and gas is the *holy grail* of developed countries, developing producing countries simply see oil and gas as their economic bargaining chip that cannot be compromised on the platform of the multilateral free trade given their largely oil dependent economies. Generally, the WTO preamble recognises States' sustainable development objective aimed at meeting "their respective needs and concerns at different levels of economic development."[25]

In the spirit of the Preamble, the 'Special and Differential Treatment for Developing Countries' was created to ensure developing countries secure a share in international trade that commensurate with the needs of their economic development through granting them concessions on their MFN treatment obligations. However, the issues which the 'Special and Differential Treatment' provisions were created to address are in no way related to natural resources. More so, the perception by developing countries that the WTO was a "rich man's club" was not disabused by the 'Special and Differential Treatment' clause.[26]

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[23]Wen-Chen Shih, '*Energy Security, GATT/WTO, and Regional Agreements*' Natural Resource Journal, (2009) Vol.49 at 440.

[24]See generally, Maniruzzaman, A.F.M., '*The issue of Resource Nationalism: Risk Engineering and Dispute Management in the Oil and Gas Industry' in* Texas Oil, Gas, and Energy Law (2009-2010) Vol 5. No.1 pp. 79-108.

[25] See Preamble to the Marrakesh Agreement Establishing the WTO. See also the Panel in *India-Quantitative Restrictions* where the Panel categorically recognised the need for need for specific exceptions from general rules for developing countries to address their special concerns. See Para 7.2

[26] Firstly, although this clause was an eventual victory following their campaign since the Dillon Round in 1960 for improved market access for their products to expand their export earnings, the fact that the GATT was designed to liberalize trade in predominantly manufactured products meant they regarded the benefits from the 'Special and Differential Treatment' clause as 'marginal' since they are generally in no position to compete for export markets in manufactured goods or semi-finished products. And being that natural resources were situate within their territories, it became their '*holy grail'*. Secondly, the clause is at best, an 'enabling clause' that gives States legal basis for exercising discretion in granting developing countries such preferential treatment. It was never designed to be a legal obligation in favour of developing countries.

National oil companies and the 'State Attribution' doctrine

Crucial to the discourse is the role of National Oil Companies (NOCs) as central figures in the regulation of oil and gas operations. About 80 per cent of the world's oil reserves is now controlled by state-owned companies.[27] More so, host countries are known to arrogate greater involvement in managerial decisions and control of oil and gas operations to their NOCs. In addition to the considerable eminence of IOCs, the traditional dominance of NOCs requires that firms are relevant to the discussion on oil regulation and must be treated separately.[28]

Investments in oil exploration and production are typically drawn in international petroleum agreements (IPAs) between states and IOCs as non-state actors on a bilateral level.[29] Developing states facilitate IPAs largely through their NOCs. However, the bilateral nature of oil and gas agreements between a state and non-state actors means it is almost unheard of for international oil and gas agreements to be mentioned in trade law disciplines as only states can be parties to the WTO rules.[30] But if we must make sense of the role of the WTO rules in international oil and gas contracts, then we must have the gruelling conversation of establishing how or whether the WTO principles has any relationships with international oil and gas agreements.

[27] Yergin, D., 'It's Still the One', *Foreign Policy* (2009) September to October. Author noted that 15 of the 20 largest oil companies are state-owned.

[28] Ghosh Arunabha, 'Seeking Coherence in Complexity? The Governance of Energy by Trade and Investment Institutions' (2011) *Global Policy* Vol. 2. September. 106 – 119, at 110.

[29] The major ones being the production sharing contract, the concession contract and the risk service contracts in the case of oil; and natural gas agreements such as gas sales and transportation agreement, gas balancing, etc. These contracts embody the state's regulatory framework on licenses, permits, special tax laws, work programmes, etc., with defined rights and obligations of both parties.

[30] The word '*agreement*' or '*contracts*' is inherently a matter for commercial relationships between non-State parties or between a State and a non-State party, while trade measures which are matters of policy are negotiated between States only.

Actually, it does not – if that is simply the question. But what we are really getting at is how the rights and obligations in an investment contract between a state and IOCs as non-state actors can possibly interfere with the state's other obligations under WTO law. Chapter four unveils three possible ways we can discern this bizarre link between NOC's relationship with IOCs and states' violation of their WTO obligation.

First it seeks to establish whether the implementation of some terms in IPAs such as the sharing formulas and tax regimes in Production Sharing Contracts (PSCs), as well as discriminatory allocation of acreage and work programmes in an exploration contract, are regulatory and political in nature – enough to possibly constitute TRIMs by way of less favourable treatment to IOCs which ultimately affects IOCs' export capacity.[31] *Secondly,* it will consider whether NOCs' role in managerial decisions in the implementation process is regulatory and therefore attributable to the state to qualify as 'measures' to bring the state in violation of their international obligation under the WTO Law since only states can violate treaty obligations.[32] And *thirdly*: that such 'measures' are of such magnitude that they inspire non-compliance to international trade obligation.

<u>Gas Pipeline Companies: the 'Essential Facilities' and 'State Attribution' doctrines</u>

Just as NOCs play a major role in influencing border measures and TRIMs in the oil sector, the same can be said of dominant pipeline undertakings in the gas sector who in

[31] *Trade effects* of IPAs here refers to any impact on export volume. However, this is distinguished from IPAs having *trade elements* such as trade clauses within them or even a stand-alone trade agreements such as *Purchasing Agreements* and *Gas Sales Agreements.*

[32] See R.J Dupuy in *Texaco v. Libyan Arab Republic* (1977) 41, 474, para.66. See also Crawford, J., *The International Law Commission's Articles on State Responsibility,* (Cambridge University Press, 2002) at 81 for an elaboration of the 'objective' nature of element of breach of treaties, customary law, and general principles of international law; *Yearbook of the ILC* 1973, vol. II, p.179. See also

their position as dominant undertakings in the internal energy market restrict third party access to pipelines, a measure that stifles competition with implications for availability of gas commodity at the city gate.[33] In tackling this 'market access' challenge the essential facilities doctrine, which requires dominant undertakings to provide access to networks to ensure the effective competition, becomes imperative. Chapter five examines the merits of the doctrine to ascertain its viable application to the gas sector.

The 'state attribution' doctrine also becomes suitable in ascertaining instances where acts of dominant undertakings (natural monopolies) may be attributed to states since states design regulatory frameworks for the functioning of networks within their jurisdiction through National Regulatory Authorities (NRAs). Meanwhile, there is the resource access challenge of bulk transfers occasioned by politically-motivated export restrictions by producing states out with the exceptions under Article XX (g) of the GATT. Transit countries creating pipeline operational bottlenecks also comes into play.

1.2 Research Problem

While the WTO have made several efforts to troubleshoot and enhance the GATT in its current form to be more efficient in governing oil and gas,[34] those efforts misjudge the intricate nature of border measures and TRIMs in both sectors, as well as those underlying institutional and regulatory architecture that shape them in line with

[33] The court in *Michelin v Commission* held that an undertaking with dominant position "has a special responsibility not to allow its conduct to impair genuine undistorted competition in the common market". See *Nederlandsche Banden-Industrie Michelin v Commission* Case 322/81 (1984) E.C.R. 3461. Para 70

[34] Efforts include: The US led inclusion of export restrictions in the Tokyo Round negotiations (1973-1979) following the oil shocks of the 1970s; the Negotiation Group on Natural Resource-Based products in the Uruguay Round negotiations which focused on 'dual pricing' and export restriction, making the case that they be reviewed to incorporate the provisions of the Negotiating Group on Subsidies and Countervailing Measures as provisions of the SCM Agreement could be relevant to petroleum and petroleum products; and recently, the *World Trade Report 2010* with focus on trade in natural resources.

economic realities of producing states, especially developing and emerging economies producing states. For instance, in spite of GATT Article III:4 on internal regulation prohibiting local content requirements; Article XI:1 on prohibiting quantitative restrictions; and Article XX (g) on conservation of natural resources as exception to Article XI:1, these measures still thrive in the sector.

The EU Trade Commissioner Peter Mandelson on behalf of the EU particularly called for a new round of WTO negotiations with particular focus on Energy.[35] There have even been academic discussions and debates over the WTO's role in regulating trade in the markets for energy and raw materials.[36] Even UNCTAD came to admit that "tariffs in the energy sector typically reflect more the dictates of energy policy - securing adequate supplies - than a trade policy in the classic sense"[37] and therefore concluded that the Uruguay Round hardly had any impact on MFN tariffs for crude oil and only a limited impact on petroleum products.[38]

Developments across the energy world as will be seen, are presenting a strong case for some form of regulatory structure that incorporates a multilateral trading regime for oil and gas with triggers for a more prominent role of the WTO (both regulation and dispute

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[35] Marc Champion & Juliane von Reppert-Bismark, *Politics & Economics: EU Trade Chief Poses WTO Rules in Energy Sector*, WALL ST. J., June 23, 2006, at A6. Available at http://www.wsj.com/articles/SB115102885450888385

[36] The 2008 WTO Session on 'Markets for Raw Materials and Energy' posed two central questions amongst its various topics. They were: '*What is the role of the WTO in the markets for raw materials and energy*?' and, '*What are the possibilities for the WTO to reduce trade distortions in the markets for raw materials and energy*?' See WTO Public Forum 2008: Trading into the future, 'Markets for Raw Materials and Energy- What role for the WTO? http://www.wto.org/english/forums_e/public_forum08_e/programme_e.htm Visited 5th December,2012; See also, Claude Barfield, '*Trade and Raw Materials- Looking Ahead (September 29, 2008).* Available at http://www.aei.org/article/economics/international-economy/trade-and-raw-materials--looking-ahead/ (Last visited April 12, 2013)

[37] UNCTAD study on '*Trade Agreements, Petroleum and Energy Policies*' 2000. p. 26

[38] *Ibid* at 27.

resolution). However, the WTO rules in its current form clearly does not meet that expectation – as such making a 'global energy governance' evasive. Suffice to say the oil and gas sector has a remotely existent yet detached relationship with the multilateral trading system. This research scratches the surface and identifies **four underpinning legal factors** that present inherent challenges for any prospect of a global energy governance under the auspices of a multilateral trade regime. They include:

1. *Loopholes within GATT rules relevant to the oil sector (Article XI and XX (g))*
2. *Strong legal justifications in resource-focused regimes that inspire the implementation of restrictive border measures and TRIMs in the oil and gas sectors*
3. *Regulatory Acts of National Oil Companies are linked to states and have international trade implications, yet acts of NOCs are not governed by international trade law.*
4. *Market access challenge in gas trade does not relate to import restriction but liberalization, and liberalization (access to networks) in gas trade is not liberalization (free trade in commodity) in the WTO sense*

These four problematiques will form the basis for an examination of the difficult relationship between the WTO rules as an *'inclusive'* regime and the energy-focused regimes as *'exclusive'*, and *'partially inclusive'* regimes.[39] The implication of adherence to the norms of the energy-focused regimes is that since the Multilateral Trade Agreement, which are integral parts of the WTO Agreement including the provision of the GATT has binding force on all Members,[40] the problem of non-compliance with WTO obligations

[39] On the one hand, the WTO's developmental objective seeks free trade amongst all Members as a globally **inclusive** community (a multilateral regime). Conversely, the energy-focused regimes namely: OPEC, the ECT, UN resolution XVII of 1962 on PSNR, and national energy legislations, seek the developmental objectives of interest state parties which they facilitate through trade restrictions that benefit them either exclusively as individual national states or exclusively as part of interest group, or partially inclusively as part of a comprehensive region. The UN Resolution on PSNR as a customary international law principle recognises regulatory rights **exclusively** for the development of natural resource producing countries within their respective sovereign territories. See Paragraph 1 and 2 of the UN Resolution on PSNR. OPEC promotes its objectives as an **exclusive** interest group i.e., for producer-only states (a plurilateral regime). See Article 2 (a) (b) and (c) OPEC Statute. The ECT regime is a legally binding agreement that promotes energy cooperation as another **multilateral** regime as with the WTO but as an **exclusive** unit for members within EURASIA (a multilaterally exclusive regime). See Articles 18 (4), 29 (4) and 5 (3) ECT.

[40] Article II (1) of the Marakesh Agreement establishing the WTO which defines the scope of the WTO

arises. Particularly because there are economic and legal justifications for non-compliance since the resource-focused regimes which also have their foundations in international law.

1.3 Research Question

Main Question:

How can border measures and TRIMs in the oil sector compared to the gas sector and arising from multipolar resource-focused regimes be reconciled with a possible co-operative energy governance with the multilateral trading regime?

***Sub Questions*:** In addressing this question, five sub questions are raised as follows:

1. *What are the conflicts between energy-focused international institutions/regimes and the WTO rules applicable to energy?*

2. *What are the trade effects of border measures and TRIMs arising from these regimes and what impacts do they have on the competence of the multilateral trading regime?*

3. *Can the GATT reconcile these 'resource access' trade effects in the oil sector compared with the 'market access' trade effects in the gas sector?*

4. *What tools does the WTO have or need to have to tackle the challenge of competing competence between it and the resource-focused regimes?*

5. *How can these conflicting regimes co-exist to achieve a co-operative energy governance?*

1.4 Summary of Literature

This complex relationship have been viewed from the lens of the evolutionary nature of energy-based institutions and their normative divisions, and that these fragmented norms create the problem of insufficient global institutions for energy governance, and that we should aim for a unitary regime in the fashion of the UNFCCC for climate change, WTO for international trade, WHO for communicable diseases, and IMF for global finance (Van de Graaf, 2013).[41] Some authors have adopted this institutional structure approach to understanding global energy governance.[42] Others have instead called for a more robust GATT rules to ensure a healthy relationship between energy-focused institutions and the WTO rules relevant to oil and gas.[43] Others have questioned the potency of global multilateralism in international trade in a world where the attitudes of the BRIC countries (which have high stakes in energy resources) towards the WTO is divergent and somewhat cryptic while cosying up to their relationships with the EU instead (Leal-Arcas R., 2011).[44]

While acknowledging the basis for the centralised institutional approach especially that with proliferation of institutions, discussions on international energy governance would be very cumbersome since no issue is completely governed by a single institution, to view these varying interests from the same lens would be intellectually naïve. Against this backdrop, this research identifies three schools of thoughts that represents this dilemma between the role of the WTO in oil and gas governance and the potency of energy-focused regimes.

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[41] Thijs Van de Graaf, *The Politics and Institutions of Global Energy Governance* (2013, London, Palgrave Macmillan). Van de Graaf's argued that the fragmented energy institutions such as the IEA for importing countries, OPEC for exporting countries, etc., were not planned but evolved out of geopolitical interests, and a way to facilitate a global energy governance is to understand the origins, design, and evolution of such fractured global energy architecture

[42] Florini, A., and Sovacool B, K., '*Who Governs Energy? The Challenges facing global energy governance,*' 2009, Energy Policy, 37 (12), 5239 – 5248. Karlsson-Vinkhuyzen, Slvia I., 'The United Nations and Global Energy Governance: Past Challenges, Future Choices' 2010, Global Change, Peace & Security, 22 (2), 175 – 195. Lesage, *et al* 'The G8's Role in Global Energy Governance since the 2005 Gleneagle's Summit,' *Global Governance,* 2009, 15 (2), 259 -277. Also, '*Global Energy Governance in a Multipolar World*' Farnham: Ashgate, 2010. Ghosh Arunabha, 'Seeking Coherence in Complexity? The Governance of Energy by Trade and Investment Institutions' (2011) *Global Policy* Vol. 2. September.

[43] Cottier, *et al supra;* Selivanova, Y., '*The WTO and Energy, supra*

[44]Leal-Arcas R., *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance* (Edward Elgar, Cheltenham, 2011).

(1) *Export restriction and internal energy measures undermine the WTO/GATT provisions such that they are violated with impunity.*

This is the position that the WTO provision in its current form is sufficient and should not be amended by adding to or diminishing the rights and obligations of WTO members in the name of reform (Marceau, 2001).[45] It maintains that the tenets of the WTO on trade in goods is sacrosanct and requires complete compliance since the WTO is intrinsic to the contractual relationship amongst member countries, rather than some exogenous legal or normative codex. This view has wide support.[46] However, such characterization of the WTO in spite of the risk of non-compliance is what Pauwelyn described as the *'over-inclusion'* of the WTO obligation (Pauwelyn, 2006). According to him;

> The risk of the marginalisation of the WTO is one of over-inclusion of the WTO trade obligations. It is the risk that WTO obligation may be found to be violated in the confined universe of trade law, even though, in the wider corpus of global legal patterns, the conduct in question may be perfectly legal or justified (because it is permitted, or even called for, in another treaty or norm*).*[47]

This risk of over-inclusion of the WTO is particularly true in the trading regime for oil and gas. This concept of 'over-inclusion' of the WTO has been recently re-echoed from the viewpoint of the extent to which Local Content Requirement is WTO-inconsistent under the WTO jurisprudence *vis-à-vis* the practicality of LCR, given that only very few

[45]Marceau, G., 'Conflicts of Norms and Conflicts of Jurisdiction: The Relationship between the WTO Agreement and MEAs and other Treaties', *Journal of World Trade*, 2001, at 1130. See Van den Bossche, p. 62
[46]See Schropp, S.A.B., *Trade Policy Flexibility and enforcement in the WTO: A law and Economics Analysis* (Cambridge, Cambridge University Press, 2009) chpts 4 and 5. Particularly at 141; See Van Den Bossche, P., *The Law and Policy of the World Trade Organization* (2nd ed, Cambridge University Press, 2008) citing McRae's description of the WTO as the '*new frontier*' of international law, at 59-60; See Hoeckman, B.M and Kostecki, M.M., *The political economy of the World Trade System: The WTO and beyond* (Oxford, Oxford University Press, 2nd ed. 2001). pp 461-462. See also, Blackhurst, R., '*The Capacity of the WTO to fulfil its mandate*', *in* Krueger, A.O, *The WTO as an International Organization*, 1998. at 32-33; Jackson, J., *Sovereignty, the WTO and changing fundamentals of international law* (Cambridge University Press, 2006) p. 81
[47] Pauwelyn, J., "*Non-Traditional Patterns of Global Regulation: Is the WTO 'Missing the Boat*'? in *Constitutionalism, multilevel trade governance and social regulation* (2006). p. 205.

measures aimed at development of national industry can be considered compatible with WTO Law (Hestermeyer and Nielson, 2014).[48]

If this thinking is endorsed as mainstream, then the assumption will be to either give sanctions for violations more teeth under the WTO dispute settlement or to exclude the restrictive measures in oil and gas from the scope of the WTO. Both of these would present their own set of problems. Whilst the former would lead to even more political tensions (or maybe would be unfeasible), the latter would be counter-productive as it would lead to a situation which Pauwelyn conversely calls the '*under-inclusion*' of the WTO in what is apparently a trade-related issue. According to him:

> New sources of global regulation also pose a risk of *under-inclusion* of trade obligations: non-traditional sources and the non-state actors that make or enforce them (through their new norm-creating and norm-enforcing functions) may constitute unjustifiable trade barriers that escape the state-focused reach of the WTO and traditional international law more generally. This concern of under-inclusion is a real one. There is a real and present danger that they restrict trade in a manner disproportionately to the extent that they achieve social objectives.[49]

(2) *The resource-focused regimes are more specific in addressing the implicit objectives behind oil and gas measures. Therefore, the WTO rules are relevant but insufficient.*

This school of thought affirms that the multi-polar regimes governing oil and gas trade are clear, predictable, and being that the current regulatory structures are practical, the institutions are fit for purpose (Goldthau and Witte, 2009).[50] The implication of this school is that it reinforces a perceived limitation in the WTO in relation to trade in energy. Moreover, it has been observed that energy resource regulation is largely a 'behind the border' affair with non-renewable energy resources as an "internal

[48] See Holger, P. Hestermeyer, Laura Nielson, 'The Legality of Local Content Measures under WTO Law' (2014), 48 *Journal of World Trade*, Issue 3, pp 553-591.
[49] *Supra* n 47 at 219
[50] Goldthau, Andreas, and Jan-Martin Witte., 'Back to the Future or Forward to the Past? Strengthening Markets and Rules for Effective Global Energy Governance' *International Affairs* (2009) 85 (2), 373-390

resource", and as such governance of such resources inspire an exclusive competence without undermining the reality of states interdependence on energy resources that likewise inspire international cooperation of international regimes in the governance of natural resources (Arsanjani, 1981).[51] Meanwhile, the scope of the WTO's competence in energy have been questioned given a history of controversies surrounding its competence on 'behind the border' areas of the economy (Dunoff, 2003).[52] In line with this narrative, it has been suggested that the WTO provisions on its own part, in relation to these areas, arguably represents a case of *under regulation* or *regulatory deficiency*, thereby offering ample 'policy space' for domestic policy considerations and objectives behind export restrictions to thrive (Karapinar, 2011).[53]

(3) *Where those measures have trade effects, the weight of such trade effect may inspire a more constructive international agreement.*

According to this school of thought, neither a global energy governance through the current polarised institutions nor an exclusive regime for energy is feasible. This school suggests that since the exploitation of non-renewable energy resources, being an internal resources, does have extraterritorial, welfare and security of supply concerns for global players, the use of constructive international agreements and practices that aims to promote systemic intercourse and cooperation within the scope of 'international

[51] Arsanjani, M., *International Regulation of Internal Resources: A study of Law and Policy* (Virginia, University press of Virginia, 1981)
[52]Jeffrey L. Dunoff, '*The Post-Doha Trade Agenda: Questions about constituents, competence and coherence', in The WTO and the Doha Round: The changing face of world trade* (Ross P. Buckley, ed., Kluwer Law International, 2003) 59; See also Guzman, T., '*Global Governance and the WTO'* Harvard International Law Journal, 45 (2004): at 303. Its 'behind the border' problems points to questions over its competence on environment which led to the 1994 conference creating the Committee on Trade and Environment; the WTO's competence on labour regulation and rights, environment, competition policy, investment, intellectual property, etc., All of these triggered at a Ministerial conference in Singapore in 1996, another in Seattle in 1999, and the Doha Ministerial Conference in 2001.
[53]See Karapinar, B., '*Export Restriction and the WTO law: How to reform the 'regulatory deficiency'*. Journal of World Trade. December (2011). Vol. 45. Issue 6

regulation' is vital (Arsanjani, 1981).[54] Very close to this approach was the audacious call by Victor and Yueh for an 'Energy Stability Board' (Victor and Yueh, 2010).[55] They proposed that unlike every other interest group regimes, the Energy Stability Board, which should be modelled after the Financial Stability Board in the Banking Sector, should be empowered to facilitate and administer cooperation on an ad hoc basis between major energy suppliers, including OPEC as an institution, and consumers, with particular focus on emerging markets as key drivers of the energy market.[56]

Meanwhile, it has been suggested that the fragmented governance is not the problem, but fragmented rules; and therefore, fragmented governance with more consistent rules is the only realistic outcome since the tensions between multipolarity and existing regimes, fluctuating markets and exporting states interests, and between energy and the environment are the realities of fragmented energy landscape that will not go away. (Arunabha Ghosh, 2011).[57] The fragmented and cyclical nature of international law itself has been highlighted as a reason for regionalism; hence the need for a comprehensive multilateral framework that can be internalised in bilateral and regional treaties, an example being the EU which reflects forms of unilateral liberalism and constructive multilateralism by way of its relationships with the BRIC countries (Leal-Arcas R., 2011)[58]

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[54] Arsanjani, *supra* n 51 at 8. See chapter 3 for a general overview of Arsanjani's views on the subject matter.
[55] Victor David, G., and Yueh, L. 'The New Energy Order: Managing Insecurities in the Twenty-First Century', *Foreign Affairs* January/February, (2010) pp.70-71
[56] *Ibid* at pp.70-71
[57] Arunabha G., 'Seeking Coherence in Complexity? The Governance of Energy Trade by Trade and Investment Institutions' *Global Policy* (2011) September, Special Issue, Vol 2.
[58]Leal-Arcas R., *supra*. The author focused on the possibilities of both a multilateral investment treaties and a cooperative trade relationship between the EU and BRIC countries.

Being that these separate viewpoints underscore the normative conflict between an inclusive and exclusive regulatory regime, an analysis on systemic integration of fragmented international subsystems, normative conflicts of subsystems of international law, and hierarchy of norms applicable to this study becomes imperative.[59] The ground-breaking Appellate Body Report in *US-Gasoline* was the turning point. In interpreting Article 3.2 of the DSU which directs panels and the Appellate Body to interpret the WTO agreements according to the 'customary rules of interpretation of public international law', the Appellate Body ruled that "the GATT is not to be read in clinical isolation from public international law".[60] While there is the positivist stance on the principle on fragmentation of international systems and systemic integration,[61] there are those that see the fragmentation of multilateral institutions as an affront to international law as a complete structure, and are equally sceptical about any hope of solving the conflicts resulting from this fragmentation of multilateral systems.[62] There is balanced position nonetheless.[63]

[59]Pauwelyn, J., *Conflict of Norms in Public International Law: How WTO law relates to other Rules of International Law* (Cambridge, Cambridge University Press, 2003); UN General Assembly 56th and 58th Session of the International Law Commission, '*Fragmentation of International Law: Difficulties arising from the diversification and expansion of international law*' April 2006; Ralf M., and Pauwelyn, J., '*Conflict of Norms or Conflict of Laws: Different techniques in the fragmentation of International Law' in Multi-Sourced Equivalent Norms in International Law* (2011)
[60]AB Report, US-Gasoline (WT/DS2/AB/R), adopted on 20 May 1996. 16
[61]Campbell McLachlan., *The principle of systemic integration and Article 31 (3) (c) of the Vienna Convention'. International and Comparative Law Quarterly.* April 2005, Vol. 54 . 279-320. Campbell holds the view that fragmentation and systemic integration are realistic in today's international law, and so should be embraced as a feature of international law.
[62]Gunther Teubner and Andreas Fischer-Lescano., '*Regime-Collisions: The vain Search for Legal Unity in the Fragmentation of Global Law',* Michigan Journal of International Law (2004), Vol. 25, No. 4.
[63]Gerhard Hafner., '*Pros and Cons of Fragmentation of International Law*' Michigan Journal of International Law (2003-2004), Vol. 25.

1.5 Research Justification and Contribution to Literature

Literatures have at best provided theoretical knowledge on the broader issue of the complex nature of energy governance. Wilson in 1987 lamented that while energy remains an issue of global public domain, work on energy, especially its international dimensions, is "largely descriptive, athoretical, and noncumulative".[64] With recent changes to the energy trade landscape outlined below, a practical understanding of why states act the way they do, followed by a deliberate and practical approach to co-operation towards realistic outcomes for energy governance becomes imperative.

Recent developments point to shifting patterns in the energy world that has necessitated the call for a global energy governance. Currently, in addition to the *recent WTO decision against local content requirement*[65] where the Appellate Body held that local content requirement is inconsistent with international trade rules, there are impending policy changes in global energy markets due to falling investment in oil and gas. There is also increase in non-OPEC production in the producers spectrum; the implications of U.S government's lifting of its oil export ban for OPEC countries following an initial approval of just two companies to export crude while still maintaining export restriction on LNG export to other regions except countries within NAFTA; the world awakens to the emergence of unconventional gas; and most intriguing is the on-going accession negotiations to the WTO by the remaining world leading energy exporters: Iran, Iraq, Libya, all in addition to Saudi Arabia's accession in 2005 and Russia in 2012. Being that

[64] Wilson, Ernest J., 'World Politics and International Energy Markets' *International Organization,* (1987) 41 (1), 125-149.
[65] *Canada- Certain Measures Affecting The Renewable Energy Generation Sector,* Appellate Body, 19 December 2012, WT/DS412/R, WT/DS426/R

these, except Russia, are major OPEC countries, their accession to the WTO will mean OPEC-WTO relationship will get renewed attention, either messier or merrier, than the attention it has today.

These developments ensure the timeliness of this research as it captures these issues with a foresight for potential WTO disputes in the oil and gas sector. Pascal Lamy's remarks is particularly instructive. According to him, *"what is sorely lacking in the current WTO context is a constructive and forward-looking discussion among members on the rapidly expanding trade and energy interface… Such discussion is a pre-requisite to build up the necessary consensus on the WTO's future role in global energy governance."*[66]

1.6 <u>Scope</u>

Here the definition of natural resources is confined to non-renewable fossil energy (oil and gas hydrocarbons). Coal is excluded from this research coverage because several factors make oil and gas more special than coal. These include:

(a) The high commercial value of fossil energy resources in the energy mix. World merchandise trade in natural resources is 23.8%, second behind world merchandise trade in manufactured goods at 66.5% (though the yearly growth rate percentage in trade in natural resources is marginally higher than in manufactured

[66] Pascal Lamy on his speech calling for a dialogue on trade and energy in the WTO. Speech delivered at the WTO Secretariat on the occasion of the '*Workshop on the Role of Intergovernmental Agreements in Energy Policy*' organized by the Energy Charter Secretariat. April 29, 2013. Available at https://www.wto.org/english/news_e/sppl_e/sppl279_e.htm

goods. i.e., 10% average growth for manufactured products and 20% average growth rate for natural resources) and fossil energy make up 11% of that growth.[67]

(b) Oil and gas resources accounts for over 70% of the world's production of natural resources.

Also, although trade measures in energy products and energy services include export subsidies, import requirements, export tax, etc., this research does not venture into the details of these particular measures because these measures mainly apply to trade in petroleum products, and this research does not focus on petroleum as secondary product but petroleum as a primary product.

This research discusses prohibited performance requirements (an investment tool employed by host governments in negotiating FDIs) not in its wide-ranging models[68] but within the confines of those prohibited under the WTO with particular focus on those prohibited under the Agreement on Trade-Related Investment Measures (TRIMs Agreement). While performance requirements prohibited under the TRIMs Agreement include local content requirements, export controls, trade balancing requirements, and foreign exchange restrictions, it further narrows its examination to local content requirements and export controls. These two are more used in the oil and gas sectors, yet as it has been observed, the TRIMs Agreement is limited as it applies only to manufactured goods and has no definite prohibition on export performance requirements.

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[67] World Trade Report, 2010 at pp. 54 & 56.

[68] Those prohibited under the WTO TRIMs Agreement; those prohibited under IIAs such as BITs and at regional levels (joint venture requirements, employment requirements, export requirements, research and development requirements, requirements to transfer technology, etc.); and those not subject to prohibitions.

Lastly, this research acknowledges that 'export quota' is also a problematic export-related measure. However, export quota is mainly rife in the raw materials sector. This research is focused on oil and gas, and especially in the oil sector, 'production restriction' and 'export ban' are more pertinent.

1.7 Research Structure

Following this background summary, **Chapter Two** presents a definition of normative conflict and competence in their legal and policy context and their application to the normative conflicts between the WTO rules relevant to energy and OPEC, ECT, UN Resolution XVII of 1962, and national energy legislations. It applies international law jurisprudence on normative conflicts, hierarchy, regime competence, and systemic integration of international norms to these energy-focused relationships. **Chapter Three** discusses the legal character of each of these regimes side-by-side the legal character of the WTO to determine the weight of their normative force and competence in regulating border measures and TRIMs in oil and gas

Chapter Four and **Chapter five** distinguishes border measures and TRIMs with 'resource access' trade effects peculiar to the oil sector from border measures relating to fixed infrastructure (pipelines) with 'market access' trade effects bothering on competition issues peculiar to the gas sector respectively. Each chapter critically illuminates how each industry works in terms of border measures and TRIMs and how their peculiarities have implications for the multilateral trading system in each sector. It aims to distinguish the varied trade effect of each measures on the WTO's regulatory competence *vis-a-vis* OPEC regarding oil; the ECT regarding gas; and national laws regulation of oil and gas contracts through NOCs applicable to both oil and gas. **Chapter Six** will give conclusive remarks on the salient issues addressed and further explore a possible re-examination of rights and obligations in the energy governance architecture. These will create a clearer part to 'cooperative energy governance' rather than a global energy governance that resorts to legal constitutive process of defining rights and obligations between parties. The former takes into consideration the reality of polarised regimes in the sector and how they can co-exist. This is the better approach compared to the latter which seeks to unify them all as one body of law, which would in reality be unachievable.

2

International Law on Fragmentation of Norms and its application to Energy Regimes

2.1 Introduction

> *"the integration of world economy on the one hand, and the proliferation of subsystems to regulate them has increased the need to ensure the unity of international legal order. The potential for interplay and conflict between WTO rules and other rules of international law is huge since the WTO rules cut across almost other rules of international law.*
>
> \- Pauwelyn [69]

In the governance of trade and investment in oil and gas, relationships of conflicts between prescriptive obligations in the WTO rules applicable to energy resources and regulatory rights engraved in OPEC Statute, UN Res. XVII of 1962, and national oil and gas legislations, as well as rights and obligations enshrined in the ECT are of such an inherent nature that they cannot be avoided. This does not however suggest that they cannot under any circumstance be resolved. This chapter seeks to understand regulation of oil and gas from an institutional perspective. Employing international law principles of normative conflicts between subsystems of international law is a good way to begin.

Never mind the nature of energy interests that gave rise to a regionally comprehensive and sector-specific treaty as the ECT as well as a producer-only treaty such as OPEC, measures implemented under their auspices are normally implemented at national levels. The primacy of sovereignty accords states with independent legislative rights firmly rooted and affirmed in the UN GA Resolution XVII of 1962 on Permanent Sovereignty over Natural Resources. This Resolution has gained global acclaim as a trite

[69]Pauwelyn, J., *Conflict of norms in Public International Law: How WTO law relates to other Rules of International Law* (Cambridge, Cambridge University Press, 2003) at 491

constituent of international law. It is birthed in international economic law[70] and international human rights law.[71] Meanwhile, OPEC and the ECT are in their own right, ambits of the wider corpus of international law.

But because international law likewise have principles on how sovereign states in a world of proliferation of treaties must engage with each other in all spheres of interactions (in this case - politically and economically) through prescribed rights and obligations, the nationalistic character and exclusiveness of these resource-focused institutions or treaties becomes problematic for international law jurisprudence.[72] In seeking answers to the question of institutional conflicts, this chapter employs these international law tools to ascertain the extent to which any of the regimes or institutions is more efficient or competent in regulating border measures and TRIMs in the oil and

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[70] For a more detailed discussion of the role of international law in the progressive development of the principle of permanent sovereignty over natural resources under the United Nations system, see United Nations Institute for Training and Research, *Progressive Development of the Principles and Norms of International Law Relating to the New International Economic Order*, (UNITAR/DS/5, 15 August 1982), pp. 291-377, particularly at pp. 327-363 ; See also Brownlie, I., 'Legal status of natural resources in international law', *Recueil des Cours* (1979-I), pp. 255-271; Kamal H., ed., *Legal Aspects of the New International Economic Order* (London, New York, 1980) pp. 33- 35; See also Subedi, S.P., '*International Economic Law: Evolution and Principles of International Economic Law*' Revised Version, 2006. at 23;

[71] Article 1 of both the International Covenant on Economic, Social and Cultural Rights and the International Covenant on Civil and Political Rights (ICCPR) provides thus: "*All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence.*" Article 21 of the African Charter on Human and Peoples' Rights reads in part: "*All peoples shall freely dispose of their wealth and natural resources. This right shall be exercised in the exclusive interest of the people. In no case shall a people be deprived of it…*" Also, the principle of a peoples' rights to natural resources has been confirmed in decisions of some important human rights bodies. See the *Final Report of the Committee on International Law on Sustainable Development of the International Law Association*, June 2012, available at www.ila-hq.org also published in the Proceedings of the 75th Conference of the International Law Association held in Sofia 2012

[72] Under Customary International Law, states have discretion, firmly rooted in sovereignty, to grant access to aliens or not, based on their economic and developmental needs. However, by entering into economic ties with other states in the international community to access the benefits of cross-border trade and investment through bilateral and multilateral treaties, obligations within those treaties have a limiting effect on States' discretions. This is especially with accession to the WTO whereby Members would have agreed to "exercise their sovereignty according to the commitments they have made in the WTO Agreements"- See Appellate Body, *Japan-Alcohol*, WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R, p. 16. Consequently, the issues of conflict between a supposedly customary international law right and other international law arising from treaties becomes an issue before the public international law discipline.

gas sector compared to the others, or whether there is an equal competence between these regimes and the GATT because of their trade effects.[73]

And since an equal competence will require a fine-tuning of cooperation towards a cooperative energy system, it will ascertain whether their norms can co-exist through systemic integration or whether the energy world will have to revert to the principles of public international law governing 'conflict of norms' and 'regime competence' to determine which norm should prevail in the event of a dispute involving the conflicting norms. Ultimately, the outcome is to show how the ideals of normative theory of regulation, which are efficiency and equity, helps to arrive at some answers.

2.2 **'Institutions' and/or 'Regimes': A contextual definition**

The terms 'institution' and 'regime' is used widely throughout this research. While the term 'regime' has wide interpretations especially from an international relations perspective, it is used here interchangeably with the term 'institutions' in a generic sense to include bodies of international associations or treaties governing oil and gas commercialisation and individual states as sovereigns. There is a plethora of definitions of what constitutes international regime and a key element in the definitions is that regimes influence a 'patterned behaviour' of states so much so that without the ability

[73] Even though WTO Panels have affirmed that the substance of a measure rather than its trade effects is to be considered to render them WTO-inconsistent, and that their trade effects, at best, goes to the weight of such evidence, chapter four of this research systematically proves that the weight of trade effects of measures in the energy sector, even though justifiable under non-WTO regimes, can be paramount in giving more relevance to the WTO in the governance of the sector. See chapter 4

to regulate states' behaviour and secure compliance, regimes are said to be ineffective, if not meaningless.[74]

Because of its diverse descriptions, it has even been claimed that there is no such thing as a regime "theory" but rather there are various "theories of regimes"[75]. This research does not indulge in the rudiments of the 'regime theory', and neither does it belabour the 'theories of regimes' but it rather seeks to understand the normative constructs of energy-focused institutions in whatever form they express themselves – whether as treaties or organisations, and how these influence states' border measures and TRIMs.

Interesting to note, states do not always need structured institutions to inspire a pattern of behaviour, and neither do regimes have to be defined within the confines of jurisdictions. For instance, a definition of regime as "multilateral agreements among states…"[76] presents the concept of regime within the confines of an institutional agreement with binding obligations, yet this is not always the case. Regimes have been classified as examples of cooperative behaviour that can facilitate cooperation without necessarily having the presence of established institutions.[77] For instance, the 'oil regime'

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[74] Keohane, R.O and Nye, J.S., '*Power and Interdependence*' (Boston; Little Brown, 1977). The authors defined international regime as "*sets of governing arrangements including network of rules, norms, and procedures that regularize behaviour and control its effects*." See also Wolf, K.D., and Zurn, M., International_Regimes und Theorien der Internationalen Politik', *polotische Vierteljahresschrift,* 27:201-21; Donald Puchala and Raymond Hopkins, "*International Regimes: Lessons from Inductive Analysis*," in Krasner, S.D., (ed.) *International Regimes* (Cornell University Press, 1981) at 61-91; Haggard, S., and Simmons, B.A., 'Theories of International Regimes' *International Organization* (1987) 41 (3) at 491-517; Emst B. Haas, "On Systems and International Regimes," World Politics 27 (January 1975), pp. 147-74; Oran Young R., '*Resource Regimes: Natural Resources and Social Institutions*' (Berkeley: University of Califomia Press, 1982) p. 2; Oran Young, 'I*nternational Regimes: Toward A New Theory of Institutions*', World Politics 39 (October 1986), p. 10; Oran Young, '*Compliance and Public Authority* (Washington D.C, Reource for the Future, 1979)

[75] Peterson, M.J., 'International Regime as Concept'. e-International Relations. Available on http://www.e-ir.info/2012/12/21 /international-regimes-as-concept/

[76] Aggarwal V., *Liberal Protectionism: The International Politics of Organized Textile Trade* (Berkeley: University of Califomia Press, 1985), chap. 2.

[77] Haggard, S., and Simmons, B.A., *supra* note 74 at 495

from 1945 to the 1970s which consisted mainly of oligopolistic interdependent firms, the national rules of the producers, and ad hoc interventions by the United States.[78] As we will see in chapter four, the classification of resource focused regimes also includes acts of NOCs acting as state entities rather than upon the influence of an established institution.

Nonetheless, the most widely accepted definition of international regime acclaimed for its balanced and centralised definition is that proposed by Stephen Krasner as "sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations."[79] By this definition, states' regulatory behaviour *vis-à-vis* their compliance of norms (or non-compliance of conflicting norms) does arise from their relationships with resource-focused institutions. This is vastly useful for this research.

2.3 **Why is 'conflict of norm' important to the WTO *vs* energy-focused regimes?**

Pauwelyn in his ground-breaking literature made a critical appraisal of the normative conflicts and hierarchical relationships between WTO norms and norms from other sources of international law generally. In justifying the essence of his study, he recognized the importance of addressing the issue of conflict of norms. According to him, "*the integration of world economy and the proliferation of sub-systems to regulate them have increased the need to ensure the unity of international legal order. The potential for interplay and conflict between WTO rules and other rules of international law is huge since WTO rules*

[78] *Ibid* 494 - 495

[79] Krasner, S.D., '*Structural Causes and Regime Consequences: Regimes as Intervening Variables' in* Krasner, S.D., ed. *International Regimes* (Cornell University Press, 1981) p. 2. See also, Aggarwal, V., *supra* n 76

cut across almost other rules of international law".[80] Apparently, the first step on interpretation of the international rules on normative conflicts is to determine the existence and extent of such conflicts. Oil and gas are so vital to the world economy that conflicts between institutions and national regimes 'regulating' their trade and investment measures deserves more importance than it gets.

Another case for examining oil and gas regulation from the lenses of international law is that whilst these resources which are described as "internal resources" to a large extent provide specificity and practicability to the realities of international oil and gas transactions, the cross border and geopolitical nature of oil and gas have foundations in international law; thereby necessitating the need for 'international regulation'.[81]

In addressing the first research question of conflict and competence, to look for answers only within the WTO rules (i.e., to insist on the multilateral trade regime of the WTO) in its current form will almost certainly be unseemly due to the WTO's limitations on energy issues.[82] Conversely, to completely resort to the ECT, OPEC, and UN Res on PSNR that engender exclusive and/or regional governance is to cede trade in oil and natural gas, which are commercial goods, to regimes out-with the WTO. By so doing, we would be limiting oil regulation to OPEC as a producer-only associations; natural gas regulation to the ECT as a regional/sector-specific treaty; and trade-related investment measures regulation to national local content laws in their oil and gas sectors.

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[80] Pauwelyn, *supra*

[81] Arsanjani, *supra.* However, the problem of lack of a comprehensive international body governing oil and gas trade becomes an issue and is also acknowledged in this research.

[82]Collier, P., and Venables, P.J., 'International rules for trade in natural resources'. Working Paper, WTO Economic and Research Division, 2010. p. 20

To insist on such exclusive management in a world that increasingly seeks to promote states' interdependence on oil and gas relations across borders and across regions may likewise be objectionable as this will further aggravate a deviation from reciprocity and the 'comparative advantage' principles imbibed by the WTO. Moreover, it would mirror Paul Krugman's 'New Trade Theory' which pitches growth of infant industry as more desirable, especially for developing countries, than comparative advantage in today's competitive world.[83]

2.4 **<u>Normative Conflict (A Definition)</u>**

The definition of when two (or more) norms of international law are in conflict has both a strict and broad definition. We discuss these definitions and their relevance to conflicts in energy governance.

2.4.1 <u>Strict Definition</u>

Jenk proposed the first classic definition of conflict in strict terms. According Jenk, "[a] conflict *in the strict sense of direct incompatibility* arises only where a party to the two treaties cannot simultaneously comply with its obligations under both treaties". [84] What can be deduced from Jenk's definition is that two norms are in conflict only when - they

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[83] Krugman, P., 'Increasing returns, monopolistic competition, and international trade', *Journal of International Economics*, November, (1979). Vol. 9 Issue 4. Pages 469-479. Krugman observed that because the developed countries were early entrants of economies of scale, they developed their industries, and so have stronger competitive advantage (or monopolistic competition). Because of this, comparative advantage is not necessarily feasible for developing countries who cannot compete on the same level playing field. In this situation of oil and gas resources, adherence to this theory would mean a WTO regulation of free trade in oil and gas would put developing countries at a disadvantage, and so, equilibrium can only be achieved if they protect their industries through exclusive and restrictive measures, and a strengthened industry would then mean their local industries can compete in production.

[84] Jenk Wilfred., '*Conflict of Law-Making Treaties*' (1953) 30 BYIL 401 at 426. Subsequently supported by Kelsen, *Theorie Generale*, 161

are both mutually exclusive contradictory obligations (i.e., *obligation not to do X vs obligation to do X*).

Otherwise known as an **Inherent Normative Conflict**, it describes where a norm *in and of itself* contradicts another. The notion of inherent conflict suggests that conflicts have to be inherent in norms. i.e., the two treaties just by their existence, without the need for any action that would give rise to breach of either, are already in conflict and so cannot possibly apply to the same party. It suggests that if a state becomes in breach of an obligation under a treaty only when it does an act permitted by another treaty (or avail itself of its right in a treaty), then there is not really a normative conflict between both treaties because conflict would be contingent upon exercising an act under a permissive norm rather than the two norms being in conflict. And since the exercise of 'rights' are a matter of choice than of compulsion, then should states choose not to exercise their right under a treaty to do X, their obligation under another treaty not to do X is not breached, therefore there is no conflict.

This strict definition has been similarly proposed.[85]It has also been adopted by the Panel in *Indonesia –Autos* where the panel stated thus: "under public international law a conflict exists in the narrow situation of mutually exclusive obligations for provisions that cover the same type of subject matter".[86]

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85 Wolfram Karl, 'conflicts Between Treaties' in, R. Bernhardt (ed.), *Encyclopedia of Public International Law* (Amsterdam: North-Holland, 1984), VII. 468.

86 WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998, Para 14.49. See also the Appellate Body in *Guatemala-Cement* (WT/DS156) Para.65 where the AB adopts Jenk's strict definition, and accordingly did not consider contradiction between an obligation and a right as 'conflict'.

2.4.2 *Broad Definition*

Some authors have faulted the strict definition on two grounds: First, that it confines 'conflict of norms' only to conflicts between obligatory norms (i.e., between *prohibitory* obligations) and does not pay attention to conflicts between a *prohibition* to do X and the *permission* to do X (which is a grant of *right*) and secondly, that a subject not availing themselves of the permissive norm does not remove the conflict if the conflict is still possible should they avail themselves of their rights in the permissive norm.[87] Therefore it faults the strict definition's position that performing a right to do an act is irrelevant to the issue of conflict since it is a matter of choice. They however admit that such a conflict, though it suffices as a conflict, is not a genuine conflict. Conflicts have therefore been given broader interpretations. For instance, situations whereby rules have 'potential for latent inconsistency' have been qualified as one of conflict.[88] Aufricht on his part defined conflict on the basis of subject matter rather than obligation in a strict sense. According to him, "[a] conflict between an earlier treaty and a later treaty arises if both deal with the same subject matter in a different manner".[89]

Problems with both definitions

Going by the strict definition there would be no conflict between OPEC and the WTO, being that while the WTO embodies obligations, OPEC does not. The problem with

[87] Hart, H.L.A. 'Kelsen's Doctrine of the Unity of Law', *in* Keifer and Munitz (eds), *Ethics and Social Justice*, Albany: SUNY Press, 1970, pp. 171- 199; Munzer, S., 'Validity and Legal Conflicts', *Yale Law Journal*, vol. 82, (1973), pp. 1140-1174; Hill, H., 'A Functional Taxonomy of Normative Conflict', *in* Law and Philosophy 6, (1987), pp. 227-247; Lindahl, L., 'Conflicts in Systems of Legal Norms: A logical point of View', *in* Brouwer, B., *et al* (eds.), *Coherence and Conflict in Law*, Proceedings of the 3rd Benelux-Scandinavian Symposium on Legal Theory, Amsterdam/Deventer/Boston: Kluwer Publisher, 1991, pp. 39-64.
[88] Hersch Lauterpacht, 'The Covenant as the "Higher Law" '(1936) 17 BYIL 54 at 58.
[89] Hans Aufricht, 'Supersession of Treaties in International Law' (1952) Cornwell Law Quarterly 655 at 655-6

coming to this conclusion is that even though OPEC does not impose an obligation, states most times, in the spirit of their collective interest, do comply with OPEC Conference's directive (or exercise their right) to restrict oil production, which may mean that they - by so doing, undermine their obligation under the Article XI:1 of the GATT prohibiting 'quantitative restrictions'. Again, by the strict definition, there would not be any conflict between the WTO and the UN Res. on PSNR either, since the WTO *prohibits* while the Resolution *permits* or recognises the *rights* of states to grant "authorization, restrict, or prohibit activities" in furtherance of the exploration, development and disposition of their resources.[90] Hence this definition does not capture the reality that states normally exercise this sovereign right, thereby creating an underlying breach of their WTO obligation.

On the other hand, a problem with the broad definition is that it is too simplistic. It infers conflict once there is any divergence whatsoever without paying attention to the importance of elements that may or may not constitute a conflict even though there are differences. It assumes that divergence translates into conflict without room for interpretation.

2.4.3 Balanced Definition (Conflict in Applicable Law)

Pauwelyn built upon the broad definition to develop a definition that looks to capture every situation possible. He proposed a more balanced (and appropriate) definition of conflict that incorporates the thinking behind both the strict and broad definitions. He defines two norms to be in a relationship of conflict "if one *constitutes, has led to, or may*

[90] Paragraph 2

lead to, a breach of the other".[91] From this definition, we can infer that a relationship that '*constitutes'* conflict is one that have no need of any action or inaction by a party to give rise to conflict and this draws from the strict definition. Conversely, his reference to '*has led to'* subscribed to the broad definition in that it presupposes a party has acted on a norm or availed itself of its rights in a permissive treaty and such action has led to a conflict with the other treaty. This is where a norm will constitute a breach of another norm *once it is exercised or complied with;* even though the norms may not *in and of themselves* inherently conflict. And then his reference to '*may lead to'* gives room for possible conflict that is not even envisaged or noticed in the two treaties. He calls this definition '**Conflict of Applicable Law'** (necessary or potential conflict).[92] And all these elements may be established as conflicts regardless of whether it is a right or an obligation that are in conflict.

Panels have subsequently recognised that conflicts may no longer be restricted to only conflicts between obligations but also between and *obligation* and a *right*.[93] The Panel also in *EC-Bananas* defined conflict as including "the situation where a rule in one agreement prohibits what a rule in another agreement explicitly *permits*".[94] From this definition, we see a rule that grants permission to do what another prohibits is a matter of state discretion, and since both rules (permissions or obligations) apply to the same state, then it is the application of the rules of these laws that are in conflict, not the two laws.

[91] Pauwelyn, J., *Conflict of norms in Public International Law: How WTO law relates to other Rules of International Law* (Cambridge, Cambridge University Press, 2003) at 175-6
[92] *ibid*
[93] US-Underwear (WT/DS24) para 15
[94] Panel Report on *EC-Bananas,* para. 7.159.

This position is also affirmed by Statute. The Vienna Convention on the Law of Treaties (VCLT) recognizes incompatible treaties as those embodying "…the *rights* and obligations of state parties to successive treaties relating to the same subject matter".[95] We note the global acclaim of the VCLT as an important instrument on the legal framework of treaties.[96] Even the WTO Dispute Settlement Understanding (DSU) affirms that it is guided by customary rules of interpretation of public international law as laid down in Articles 31 which sets the ground rules for interpretation of treaties, and 32 of the VCLT which is a supplementary provision to Article 31.[97]

There is yet another possibility of conflict between two permissive norms (*a right versus a right)*.[98] This kind of conflict encompasses the legitimate intentions of two separate laws proffering rights to two separate parties based on their legitimate interests.[99] What comes to mind is the ECT *permitting* freedom of transit *versus* the *right*s of transit states to regulate transit within their territorial borders. (i.e., *The ECT v Nationals Laws).* This scenario is addressed in Chapter five under the discussion on transit countries.

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[95] Article 30 (1). See also Article 30 (4) (b) for reference to *rights and obligations.* An amended provision from its initial Article 63(1) which obligations only, and not rights. Hence, amended to include *rights.*

[96] Although not all states are parties to the VCLT, it is one of those international instruments whose central provisions are codifications of customary international law, and so have global binding appeal by virtue of their subjectivity under public international law. See ICJ, *Gabcikovo-Nagymaros Project,* ICJ Rep. 1997, pp. 7 *et seq.,* paras. 46, 99. The WTO Appellate Body also recognises the validity and relevance to the VCLT as a useful instrument for interpreting WTO law in the event of a dispute. See AB in *US-Gasoline,* WT/DS2/AB/R, pp 16; *Japan-Alcohol,* WT/DS8/AB/R, WT/DS10/AB/R, paras. 10; *India-Patent Protection,* WT/DS50/AB/R/R, paras. 45.

[97] *United States – Preliminary determinations with respect to certain softwood lumber from Canada* WT/DS136/R. 2002 at para. 7.13. Article 3.2 of the DSU. The Article requires that a panel must interpret the Agreement in accordance with this rules set out in Article 31 and 32 of the VCLT. Article 31 (3) VCLT as the most important part particularly recognises that subsequent practice of States in the application of the treaty have to be taken into account by the States since they involve case law and constitute legitimate expectations among WTO Member States. See *Japan-Alcohol, ibid* at 14 . Article 32 on the other hand simple provides for the possibility of recourse to supplementary means of interpretation if the interpretation of treaties according to Article 31 leaves the meaning ambiguous or obscure; or leads to a result which is manifestly absurd or unreasonable.

[98] Munzer, S., *supra;* Hill, H., *supra*

[99] Abdullatif A.O., *et al.,* 'On the Formal Analysis of Normative Conflicts' *JURIX 1999: The Twelfth Annual Conference, page 35-46.*

2.4.4 *Relevance of Conflict in Applicable Law to OPEC/WTO, OPEC/ECT, and WTO/UN Res XVII of 1962 conflicts*

Inherent normative conflict can be resolved by declaring one of the two mutually exclusive norms null and void while ***conflict in applicable law*** is said to be between norms that must co-exist since both are legitimate. This raises the question of 'which of them prevails?' The situation in ***conflict in applicable law*** is remarkably very different from the traditional conflict. It is a much more complex situation of conflict.[100] Since this chapter deals with conflicts between legitimate treaties, it is in most part, about *conflict in applicable law.* However, where the UN Res on PSNR may also be seen as imposing an obligation on states, I also traverse *inherent normative conflict* in determining conflict between the UN GA Resolution XVII of 1962 and the WTO rules relevant to natural resources; not from the notion that one of them is null and void, but from the situation of both obligations not being in sync with each other.

From Pauwelyn's analysis such conflicts between norms of the WTO and non-WTO subsystems were those of conflicts between a special law as *lex specialis* and general international law as *lex generalis* (i.e., conflicts between the WTO and the UN Resolution XVII of 1962); conflicts between two special laws (i.e., conflicts between norms of the WTO as *lex specialis* on international trade in goods and OPEC as another *lex specialis* on a particular type of good [petroleum]); and the role of *lex posterior* in the event of such conflicts between norms of a *lex specialis* versus norms of another *lex specialis* regime. [101] These nature of conflicts will be expanded later on in this chapter.

[100] Pauwelyn, *Supra* n 91 at 178.
[101]*Ibid* at 131-138

2.5 **Normative conflict in oil and gas governance and the concept of 'New Sovereignty'**

Perhaps, this inter-connection between the WTO and OPEC on the one hand, and between national policies under the auspices of the UN GA Resolution XVII of 1962 and the WTO/the ECT on the other hand, brings this subject under the corpus of transnational law.[102] Transnational law inherently reflects international law not just as a law on sovereignty but also as a law on interdependence of states. That is, the law on 'co-operation'.[103] Although it will take more than just interpretations, interpretations are the first step to identifying these conflicts and proposing resolution by institutional co-operation towards a co-operative energy governance. This makes sense in getting the best out of an industry shrouded in multipolar norms rather than simply proposing a unified global energy governance that underestimates the severity of such polarity.

Interdependence of states is crucial because of this era of the 'New Sovereignty'. Chayes describes new sovereignty as this era whereby states in exercising their regulatory acts as sovereign states must act in accord with international principles, which according to the authors, ultimately guarantees to make all states better-of.[104] They noted that "when

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[102] Jessup in propounding the concept of transnational law defined it as "*…all law which regulated actions or events that transcend national frontiers. Both public and private international law are included, as are other rules which do not wholly fit into such standard categories*". See Jessup, Philip C., *Transnational Law* (New Haven, Yale University Press, 1956), p.2 .

[103] Pauwelyn, *supra* at 31-33. Pauwelyn disputes McRae's distinction between international trade law and international law as two fundamentally different systems such that while international trade law focuses on the interdependence of states, international law focuses international cooperation (independence of states). He argues that while it is true that the GATT/WTO has been kept to the sidelines of public international law, international law has progressed from the law of 'co-existence' as was the case up to the end of the first world war to the law on 'co-operation' on the basis that States now seek co-operation as a need to tackle common problems; and that international trade law exemplifies just that.

[104] Chayes, A., and Chayes, A.H., *The New Sovereignty: Compliance with International Regulatory Agreements* (Harvard University Press, 1998). In driving this 'new sovereignty' ideal, Chayes' put forward those international law, and environmental and monetary instruments employed by international officials of international institutions, non-governmental organizations, and governments, to engage in the process of

a state's conduct is challenged as inconsistent with a legal norm or otherwise questionable, the state, almost of necessity, must respond to justify its conduct, or show that the rule, properly interpreted, does not cover the conduct in question…"[105] While this may not be easy due to the multiplicity of international norms, it is at least an effort at recognising that because of that multiplicity, there should be consequences for states' acts that have international ramification, even in matters of trade.[106]

2.6 **Energy-focused Institutions as subsystems of international law**

International law by itself is not a stand-alone legal document detached from states' national laws while having the ambiance of a supreme code by which it rules over the activities of sovereign states. More so, the absence of a 'world parliament' in creating international law has even made some to believe that international law is no law at all. International law rather emanates from the agreement of states to be so governed by their negotiation of and accession to international agreements known as treaties; by consistent practice and acceptance of customs; or by representation at the United Nations in propagating natural law of the rightness or wrongness of acts which is otherwise known as the general principles of law recognized by civilized nations.[107] Judicial decisions and scholarly writings are also held in high esteem.[108]

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continuing dialogue in their application of treaty norms so much so that the norms reflect the broader interests of all states and stakeholders, rather than simply rely on the legal enforcements within the treaties.
[105] *ibid* at 119 and 128.
[106] Van Houtte had classically observed that Western countries may not view a producer-only organisation as illegitimate broadly, but its actions can be illegitimate. See Houtte, V., *The Law of International Trade* (Sweet and Maxwell, 1995), p. 117
[107] See Article 38 (1) of the Statute of the ICJ for an itemization of the sources of international law.
[108] Judicial decisions and scholarly writings of "the most highly qualified publicists of the various nations", are subsidiary means for the determination of the rules of law. What this means is that, even though not particularly regarded as 'sources of international law', they are essentials for developing rules of law that are sourced in treaties, custom and the general principles of law.

Besides the sources listed in Article 38 of the ICJ, the current international law jurisprudence recognises other international acts that have crystallised into sources of international law. Today, unilateral acts of states,[109] decisions of international organisations,[110] and agreements between states and international enterprises[111] are regarded as sources of international law even though these categorisations have been observed to have limitations.[112] While OPEC and ECT, and UN Resolution XVII of 1962 fall within the list outlined in Article 38, OPEC and the UN Resolution also fall within decisions of international organisations. Also, acts of non-state actors and state enterprises fall under agreements between states and international enterprise. And likewise, national legislations fall within unilateral act of states. These sources will form part of the analysis in this research.

All of these as sources of international law make up what is now the international law system. Each embodies different regimes and each regime is regarded as a subsystem of international law. Of all the sources of international law, the most dynamic is treaties. This is because while the others evolve very slowly over a long period of time (e.g.

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[109] See 'Guiding Principles Applicable to Unilateral Declarations of States Capable of Creating Legal Obligations' adopted by the international Law Commission in 2006. *Report of the ILC,* 58th Session, A/61/10, pp. 369-381.

[110] Such are as Resolutions of the General Assembly which do not just have recommendatory powers but is also competent to make determinations or have operative design. See the advisory opinion of the ICJ in *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution* (1971) ICJ Rep 50, para. 105. More on the General Assembly resolutions will be discussed later in this chapter with particular focus on Resolution XVII of 1962 on Permanent Sovereignty over Natural Resources.

[111] Such agreements are the types referred to in the *OECD Declaration on Guidelines for Multilateral enterprises, June 21, 1976.* para 1. It recognises that "multilateral enterprises now play an important part in the economies of Member countries and in international economic relations, which is of increasing interest to governments". International Oil Companies (IOCs) fall within this category. While Thirlway acknowledges that multilateral corporations of this kind that are capable of entering into agreements with states possesses, for some purpose such as the settlement of disputes in the context of the ICSID, a degree of international legal person, the author believes it is not certain whether the international identity of such companies is enough to qualify such agreements as a source of international law. See Thirlway, H., *Sources of International Law* (United Kingdom, Oxford, Oxford University Press, 2014) at 23.

[112] Thirlway, H., *ibid*

customs), and are somewhat static and unchanged (e.g., general principles of international law), treaties are by design the active and progressive interactions between states forming alliances to meet mostly an economic goal based on shared interests. Each treaty becomes a subsystem of international law. For instance, the ECT, OPEC and the WTO are normatively distinct regimes with different scopes and comprising both different and similar member states. Therefore, they are different systems of international law even though derived from the same source – treaty. Their divergent normative characters, coupled with the rapid nature of their proliferation have also meant the problem of conflict of norms of international law.

Conflicts between treaties, or between a treaty and a custom, or between a treaty and a general international law, are essentially normative conflicts of subsystems of international law. Because conflicts of subsystems are a part of the life of international law, the discussions on the relationships between subsystems of international law is also dynamic.[113] Indeed, the splitting up of laws into 'specialised' regimes solve those problems unique to their spheres of governance much more efficiently than general international law would. However, since treaty agreements are signed by sovereign states which are all equal under international law; and since there are no hierarchy in international law (save the principle on the UN Charter as will be seen), conflicting treaties entered into by a state having obligations to both treaties is a reality which international law must live with.[114] This problem is reflected in the landmark

[113] For a general analysis of the relationships between subsystems of international, see UN General Assembly 56th and 58th Session of the International Law Commission, '*Fragmentation of International Law: Difficulties arising from the diversification and expansion of International Law*' April 2006.
[114] For states to interact with each other in furtherance of their various interests, their different Ministries as branches of government through their designated officials conclude treaty agreements with similar Ministries of other countries. And as treaties are concluded, overlaps and conflicts with other different treaties, which in some areas, have the same subject matter do arise.

WTO/OPEC dichotomy, and the WTO-style but sector-specific ECT, which is formed for the management of trade in energy within European borders and for those linked to the ECT rather than as a globally-inclusive unit as the WTO.

2.7 Applying the interpretative rules on Regionalism and Conflicts to Energy norms

There is a bandwagon of interpretative rules of international law of treaties that could pass for mere clichés since they do not necessarily solve the problem of real conflict of norms between subsystems of international law. Klabbers revealed the nuances that comes with the subject of interpretation of treaty conflicts, while still acknowledging the essence of rules of interpretations to the jurisprudence of normative conflicts between subsystems of international law.[115]

This chapter takes a tour of the fundamentals of 'conflict of subsystems of international law', without joining the bandwagon of just another plethora of rules of interpretation of conflicts in international law. In this vein, it identifies the relevance yet limitations of interpretation of the rules on conflicts in their application to the institutions regulating oil and gas. In other words, it captures how the outcome of these limitations affects or influences the relationship of conflicts between the WTO and other resource-focused institutions.

2.7.1 *Treaties vs International Organisations (WTO vs OPEC/UN Resolution conflict)*

Conflicts between the WTO and the UN Resolution on PSNR as a general principle of International law comes to mind here. International Custom (State Practice in the energy

[115] Klabbers, J., *Virtuous Interpretation, in* Fitzmaurice, M. Elias, O. A. Merkouris, Panos , *Treaty Interpretation and the Vienna Convention on the Law of Treaties : 30 Years On* (Martinus Nijhoff Publishers , 2010)

and raw material sectors) is an unwritten source of international law. The conventional and consistent practices of export restrictions, dual pricing, and local content requirements by resource producing states are state practices that have increasingly gained status as custom with its own normative force. As such, they have crystallised into a non-WTO system that is likewise a deviation from the multilateral free trade principles as it relates to energy and mineral resources.

But the interpretation of state practice in the context of whether it should carry weight as customary international law, or whether it is a product of non-legally binding agreements is controversial. According to Jan Klabbers, "The ascertainment of state practice is - like beauty – to a large extent in the eye of the beholder. It is truism to say that actions may often be explained in more than one way, and it similarly goes without saying that words or texts may lend themselves to varying different interpretations. The question then becomes, of course, how to assess the various acts or words; how to give meaning to them".[116]

2.7.2 Treaty norms vs National laws (WTO/ECT versus National energy laws)

Regarding internal restrictive measures on investments, conflict is also perceived to exist between the WTO's TRIMS Agreement and domestic legislations such as the Local Content Requirements (LCR) in the energy sector. More so, the Energy Charter Treaty (ECT) being an investment treaty and a non-WTO regime also becomes relevant. Whilst the rules on conflict may be incapable of solving the problem of proliferation of treaties, they at least help in identifying the problems, which on the positive side leaves much to

[116]Klabbers, J., *The concept of treaty in international law* (Martinus Nijhoff, 2006) at 123

be desired in terms of practical solutions, and this research presents a step in the direction of 'practical solutions'.

2.7.3 *Treaty norms vs Treaty norms (WTO versus OPEC/ ECT)*

OPEC's status needs clarification here. OPEC being an international economic organisation (IEO) is hardly regarded as a treaty *per se*. But as an IEO, it is accorded *treaty-making competence* under the Preamble to the Vienna Convention on the Law of Treaties of 1986.[117] However, while conflicts between the WTO norms of which the GATT is central and OPEC norm may not qualify completely as conflicts between 'treaty norms' but rather as conflicts between 'a treaty and an international organisation', the principles applicable to conflicts between treaty norms has been said to similarly apply to conflicts between a decision of an international organisation and a treaty norm enacted outside that organisation.[118] This makes the principles governing conflict between treaty norms similarly applicable to the WTO/OPEC.

Regarding the ECT and GATT, the issue is with the word, 'conflict' as there are no clear cut conflicts between them. However, the 'normative disparity' between the GATT and the ECT naturally comes in focus as possible conflicts between treaty norms where adherence to the regional parameter of the ECT 'may lead to' a breach of the multilateral

[117] The term '*treaty-making competences*' covers both an IEO's ability to conclude treaties with other international organization AND a conclusion of treaties with States. It cannot be categorically stated here that the process of a State's accession to an international organization by ratification and signature is the conclusion of a treaty between that State and the international organization, but under Article 2(1)(j) of the VCLT 1986, the rules of the organization is interpreted as "the constituent instruments, decisions and resolutions adopted in accordance with them, and established practice of the organization", which includes States accession and signature, just as with treaties.
[118] Pauwelyn, at 146-147

objective of the GATT.[119] This assertion recognises that to a large extent, the ECT complements or even expands the GATT and designed for more specific situations. Two provisions have been identified in the Vienna Convention on the Law of Treaties as provisions which the Convention has been unable to resolve, and may have actually contributed to their unworkability. They are the provisions on 'reservations', and the 'rules on treaty conflict'.[120] This study focuses on the problems associated with the rules of treaty conflict. Being that the fundamental principles of treaty law are the principles of 'good faith' and *pacta sunt servanda* as also codified in the VCLT[121] public international law has always been burdened with the question of how to address adherence to obligations arising from conflicting treaties whereby a party to treaty is also party to a conflicting treaty.[122]

The Lex Priori principle

For there to be a conflict of treaty norms, the following preconditions must be in place: There must be some overlap in terms of subject matter (*ratione materiae*[123]) and state parties (*ratione personae);*[124] and they must exist or interact at one point in time (ratione temporis).[125] **Article 30 (1) & (3) VCLT** easily solves the problem of same subject matter

[119] Article 5(3) of the ECT which gives exception upon which States may implement those trade-related investment measures, which are prohibited under TRIMS Agreement being a WTO treaty agreement.
[120] Klabbers, J., 'Beyond the Vienna Convention: Conflicting Treaty Provisions' *in* Cannizzaro, E., (ed.) *The Law of Treaties Beyond the Vienna Convention* (Oxford University Press, Cannissaro, ed., 2011) at 192
[121] Article 26, VCLT.
[122] Brownlie, I., *Principles of Public International Law*, (New York: Clarendon Press, 1990), at 2.
[123] Where different treaties address different subject matters, conflicts are not envisaged. And that is simply because the issues do not clash since they are different all together. But where the subject matter is the same, and both treaties point in different direction, then there is conflict
[124] At least one party must be bound by both rules. See Pauwelyn, J., *Conflict of norms in Public International Law: How WTO law relates to other Rules of International Law* (Cambridge, Cambridge University Press, 2003) p. 165
[125] *ibid*

with the principle of *lex priori. Lex priori* simply means 'the prior law'. Article 30 (1) and (3) reads thus:

> *1. Subject to Article 103 of the Charter of the United Nations, the rights and obligations of States Parties to successive treaties relating to the same subject matter shall be determined in accordance with the following paragraphs.*
>
> *3. When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty.*

The joint interpretation of both provisions is that where there are different treaties relating to the same subject matter, the earlier (or prior) treaty prevails. The only two exceptions are as follows: (a) Subject to Article 103 of the Charter of the United Nations. Article 103 of the United Nations Charter provides thus:

> *In the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, their obligations under the present Charter shall prevail.*

Therefore, if the obligation of the later treaty is that of an obligation under the United Nations Charter, the obligation under the UN Charter will prevail over obligations under any other treaty. And (b) If the prior treaty is suspended or terminated under Article 59 of the VCLT. Article 59 provides thus:

> **1**. *A treaty shall be considered as terminated if all the parties to it conclude a later treaty relating to the same subject matter and:*
> *(a) it appears from the later treaty or is otherwise established that the parties intended that the matter should be governed by that treaty; or*
> *(b) the provisions of the later treaty are so far incompatible with those of the earlier one that the two treaties are not capable of being applied at the same time.*
> **2**. *The earlier treaty shall be considered as only suspended in operation if it appears from the later treaty or is otherwise established that such was the intention of the parties.*

From these provisions, if the parties to the later treaty agree that it prevails over the earlier treaty and that both treaties are so incompatible that they are not capable of being applied at the same time, then the later treaty prevails.

The solution offered by the *lex prior* principle has been identified by the *Lauterpacht 'Reports on the Law of Treaties'* to pose the problem of suppressing any progress that could be made by a latter treaty in the interest of the international community.[126] Klabbers reiterates this concern noting that to insist on the *lex prior* "would make the future progressive development of international law near impossible, and also that it makes the law too rigid and unresponsive to changing political circumstances".[127] The *lex priori* rule would make OPEC eternally superior to the WTO. Given that the WTO qualifies as a progressive treaty created as a responsive solution to the problems posed by protectionism and race to the bottom due to the 'prisoner's dilemma' and 'optimal tariff' which had a negative impact on global welfare, such observations by the *Lauterpacht Report* and Klabber becomes justified.

The Lex Posterior principle

The *lex posterior* principle was adopted to mitigate the shortcoming of the *lex priori* principle. *Lex posterior* means 'the later treaty prevails'. The thinking behind the *lex posteriori* is that in the search for a more realistic and effective relationship between states that meets their current situation compared to the current regime, parties enter into negotiations leading to the signing of the later treaty. Whilst this takes care of the

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[126] Para 4 of the H. Lauterpacht, *Report on the Law of Treaties'*, provides thus: 'The rule formulated under paragraphs (1) and (2) does not apply to subsequent multilateral treaties, such as the Charter of the United Nations, partaking of a degree of generality which imparts to them the character of legislative enactments properly affecting all members of the international community'.
[127] Klabbers, *supra.*

problems identified in the *lex prior* principle in terms of the future development of law, the later treaty which prevails must be between similar parties for it to make sense because it is of no use if the parties are different as it takes similar parties to conclude a future treaty. This poses another problem. Not all later treaties involve similar parties. Such is the case with the WTO-OPEC scenario where parties to OPEC are mostly WTO member states also but most WTO member States with interest in petroleum management, such as the OECD states, are not OPEC member states. Likewise, Iraq and Iran who are OPEC countries are not WTO member Countries. But assuming Iraq and Iran were to conclude their accession to the WTO, then it would mean that while every OPEC member would be a party to the WTO, not all WTO members would be OPEC members.

Article 30 (4) (b) makes provision for this situation. It provides thus:

> "*When the parties to the later treaty do not include all the parties to the earlier one: as between a State party to both treaties and a State party to only one of the treaties, the treaty to which both States are parties governs their mutual rights and obligations*"

In this case, parties to both treaties would be OPEC and WTO member States, and parties to only one of the treaties would be WTO member states. Going by this provision, the WTO would govern their rights and obligations. But then again, this situation comes with its own problems as it would be caught up with the problems associated with *lex prior*. In essence, while the *lex posterior* places the WTO as a latter treaty over OPEC, *lex priori* places OPEC as a prior treaty over the WTO. Member states to either of these get caught up in – which is superior?

More so, Article 30 (4) (b) overlooks the possibility that the treaty to which both states are parties may not be as specific on the subject matter as the other treaty. To this extent, the *lex posterior* principle is of no use to the WTO/OPEC conflict. However, it is of relevance to the WTO/ECT relationship as both treaties have not just similar parties, with the ECT being the latter treaty, but similar objectives.[128] What sets them apart is scope of influence and more specificity with which the ECT address the subject matter of transit. This will be addressed in chapter three. But what we note here is that on this basis, the ECT would be a more special treaty on energy transit compared to the WTO.

However, because of problematic treaty conflicts such as the WTO and OPEC involving different parties, and the objective similarity but difference in scope and specificity between the WTO and the ECT involving similar parties, this complex nature of treaty conflicts means treaty conflicts cannot be conclusively solved by the *lex prior* and *lex posterior* principles. Resolving treaty conflict gets difficult from here. In fact, a treaty conflict was defined as a conflict between provisions of different treaties which cannot be resolved through such mechanisms as 'reconciling interpretation' or even 'balancing' or 'proportionality'.[129] Commentary on the VCLT reiterates that "solutions under Article 30(4)(b) are not suitable where two treaties are in genuine normative conflict which cannot be resolved by allocating different sets of treaty obligations to different groups of States" [130] This brings us to the third principle.

[128] See Introduction note in the ECT, specifically on 'Trade' where it provides that the treaty's trade provision is in line with WTO rules and practice, which are founded on the fundamental principles of non-discrimination, transparency and a commitment to the progressive liberalisation of international trade. See also Article 4 of the ECT
[129] Conforti, B., *supra*
[130] 'The Vienna Convention of the Law of Treaties: A commentary' (Oxford University Press; Olivier, C., and Pierre K., eds) Volume 1, at 792.

The Lex Specialis principle

The principle of *lex specialis derogat legi generali* by interpretation accords a special law superiority over a general law provided it meets four criteria to be regarded a special law.[131] Put into context, a *lex specialis* is essentially a law governing a specific subject matter, and its prevailing effect over a law governing general matters (*lex generalis)* arises where both cannot be construed together.[132] Since no treaty is more superior to another, the *lex specialis* accords the treaty with more specificity on a subject matter, regardless of whether it is the prior or latter treaty, a kind of superiority (or a better value) over the other it is in conflict with. The rationale behind the *lex specialis* principle of international law is the need to give preference and effect to a special law or system of law that is designed with more detail and better appreciation for specific issues peculiar to parties compared to other systems or regimes to which they are also signatory – not for the sake of superiority over the other, but for the sake of its practicality. In effect, a *special* norm is the (a) more effective or precise norm which has fewer exceptions, and (b) reflects most closely, precisely and/or strongly the consent or expression of will of the states in question.[133]

The *lex specialis* principle is operative in four different situations as follows: Conflicts between (a) different provisions in a single instrument, e.g., conflicting provisions in a treaty, (b) between two different instruments, e.g., between two different treaties, (c)

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[131] Four criteria makes a treaty a special law. They include: (1) They are written rules, (2) they are an explicit expression of state intent at the highest level of government, (3) they are mostly ratified also by parliament, and 4) they constitute norms regulating a special field. See Pauwelyn, *supra* at p. 330

[132] Crawford, J., *The International Law Commission's Articles on State Responsibility: Introduction, text, and commentaries* ((Cambridge University Press, 2002) at p. 307

[133] Pauwelyn *supra* at 387

between a treaty and a non-treaty standard, e.g., a treaty vs customary international law, and (d) between two non-treaty standards.

This research is concerned with *lex specialis* in situations '**b**' and '**c**'. This is essentially between the WTO and the ECT and OPEC as between treaties, and between the WTO and the UN Resolution XVII of 1962 as between a treaty and a customary international law.

2.7.3.1 The Lex Specialis principle and the WTO/OPEC conflict

Although there are no formal hierarchy between the sources (or subsystems) of international law except where the law is *jus cogens*- whereby *jus cogens* has priority over every law, whether treaty or general law, in practical terms when the interpretation of conflict arises, there is a kind of informal hierarchy between them.[134] For instance, treaties generally enjoy priority over customs, and customs over general principles of international law. It has been established that in conflicts between a special law and a general law, the special law (*lex specialis)* applies as long as the *lex generalis* is not a *jus cogens*. This is a pretty straightforward solution. Since a special law generally prevails over a general law, it is pointless talking about conflict. Just simply apply the special law.[135]

The real problem however arises where we are faced with two conflicting special laws, whether between treaties or between a treaty and a non-treaty, e.g., the law of an

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[134] Verdross & Simma, *Universelles Volkerrecht, (Berlin: Duncker & Humblot, 1984) 3rd ed.*.pp 413-414; Thrirlway, The Law and procedure of the International Court of Justice', BYBIL Vol 60, (1989) pp. 104-106

[135] See the ICJ in *Gabbcikovo-Nagymaros Project ICJ Reports 1997* p.76, para. 132 where the ICJ found the 1977 treaty to be applicable basically on the grounds that it was *lex specialis.*

international organization. The *lex specialis* principle becomes more complicated when the harmonious interpretation of a conflict is not feasible so that there is no clear cut solution to a conflict, e.g., between two continuing treaties.[136] An example of such conflicting regimes which are special treaties in their own right are the GATT/WTO, OPEC statute, and ECT; the most prominent being the WTO/OPEC conflict.

Pauwelyn describes this conflict as AB/AC conflict. i.e., country A being a party to one regime with country B (in this case, A and B are OPEC members) while country A is also a party to another regime with country C (A and C are WTO members), and country C is not a party to OPEC, yet the subject matter covered by OPEC is of interest to country C and the WTO to which it belongs has its own rules regarding the same subject matter (trade 'in petroluem'). And so, by fulfilling obligations under OPEC, country A would be violating its obligation to C under the WTO.[137] If the *lex specialis* principle were to be taken solely in the context of a special law versus a general law, then it would be irrelevant in this type of conflicts.

For the *lex specialis* principle to be relevant here, it must go beyond that 'special law versus general law' definition. In conflicts between two special regimes, the question would be, 'which of them prevails'? There have been several approaches to solving this problem. The determination of whether a rule is special or general has been tied to either

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[136] Pauwelyn described treaties to be of a 'continuing' or 'living' nature where they are multilateral treaty norms that are part of a legal system created at one point in time but continues to exist and evolve over mostly indefinite period such as many environmental conventions, EC Treaties, WTO rules, UNCLOS, and human right treaties, and they continue to be confirmed either directly or indirectly, throughout their existence within the context of international organisations. See Pauwelyn, *supra* at 378.

[137] Pauwelyn, *supra* at 17-18. However, his classification of this AB/AC conflict as that of 'co-existence' and only between sovereign states in contract agreements, while an AB/AB conflict which is conflicting norms binding both A and B as same parties is that conflicts arising from states 'co-operation' in pursuit of common good is a conflict between two systems rather than between two sovereign states confuses the nature an AB/AC conflict as also conflict that bothers on conflicting systems and not just contracts between sovereign states.

their *subject matter* or *number of actors* it governs.[138] The 'number of parties' approach to the problem suggests that a treaty with more member States should prevail over the treaty with less party members, as more members reflect the importance of the treaty on a global scale. i.e., the more the members, the wider the geographical application.

This approach is too simplistic for the WTO-OPEC conflict because the 'number of parties' approach would make the WTO superior to OPEC while the 'subject matter' approach would make OPEC superior. More so, it would make bilateral treaties automatically less specific to multilateral treaties due to the lesser number of parties involved, while overlooking the fact that the bilateral treaty may be more direct. On the other hand, the 'substance of the agreement' approach suggests that the more confined the treaty is to a particular substantive issue, the more quality it exhibits. This is essentially a determination of whether the subject matter is focused on a particular area or is general in nature. Even this approach has been debunked as unworkable.

Another approach is that the *lex specialis* principle should reflect the core element of the *lex posterior* principle, which is that the latest expression of states' consent following changing in circumstances to suit their current economic needs, ought to prevail. However, it at the same time, escapes the problems posed by the *lex posterior* principle as discussed above, which is that *lex posterior* does not apply to treaties with different parties- only similar parties. Thus, even where all the parties to a latter treaty are not necessarily the same parties to a current treaty, as long as there is at least a party to both

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[138] Villiger, *infra* at 36; Kontou, *The Termination of Treaties and Revision of Treaties in the light of New Customary International Law* (Clarendon Press, Oxford, 1995) pp 19-20

treaties even though the others are not parties to both at the same time, the *lex specialis* principle would apply.

2.7.3.2 The Lex Specialis principle and the WTO/ECT relationship

We bear in mind that the relationship between the GATT/WTO and the ECT is not usually regarded as a relationship of conflict. Rather the ECT is regarded as consolidation or an improvement of the WTO. Because of this, the issue of 'competence' in the management of energy trade and investment rather than 'conflict' is more appropriate. Thus, the *lex specialis* principle can be interpreted not just for the purpose of determining which norm prevails in the event of a conflict, but also which regime is more competent. If we were to apply the date of enactment as guideline to determine competence, then the GATT/WTO would prevail under the *lex priori* principle while the ECT would prevail under the *lex posterior* principle. For the records, The ECT was enacted on January 1st 1994, while the WTO was signed on 17th December 1995. But if we were to go by the *lex specialis* principle, none of them would prevail merely on the basis of an earlier or a later treaty, but rather on which of them is more specific to the parties' economic situation.

Recall that the notion of parties entering a more special treaty in spite of an existing treaty of which there is a cross-element of similar, if not the same, subject matter. That argument brought about the shift from *time of enactment* to *specificity* of the treaty with the assumption that the special treaty is usually a later treaty. While the WTO/GATT is applicable to trade in all goods, the ECT is specific to trade in investment in energy goods. While the WTO is a multilateral treaty that establishes rights and obligations of global members over trade issues, the ECT is also a multilateral treaty that establishes legal rights and obligations with respect to a more defined range of trade and investment matters peculiar to mainly Europe and Russia (with the exception of Russia and Australia).

2.7.3.3 'Subject Matter' Specificity and the WTO/OPEC/ECT relationship

The ILC appeared to have offered an answer to the question by observing that while treaties generally enjoy priority over custom, particular treaties enjoy priority over general treaties.[139] This suggests the notion that the more specific one would prevail. But again, the question which is more specific is not always clear-cut. Also, there is the question of – how do we determine specificity'? This notion of 'general treaty' versus 'particular treaty' seems to be that even though both are treaties because they cover a specific area or subject matter, the particular treaty is more tailored to a particular product within the general subject matter compared to the general treaty.

It can be argued that where a treaty is formed solely to address or govern a particular product, such as oil in the case of OPEC, then it is the particular treaty. While on the other hand, although the WTO is also a special law as it specially governs trade as a special field, it is *lex generalis* compared to OPEC and the ECT in relation to oil and gas as product subject matters.[140]

Because of this, the WTO can be both a *lex specialis (*when compared to other general law) and a *lex generalis* (when compared to OPEC and the ECT). The *Convention on Anti-*

[139] UN General Assembly 58th Session of the International Law Commission, '*Fragmentation of International Law: Difficulties arising from the diversification and expansion of international law'* April 2006. Para 83.
[140] The ILC 58th session stated that generality and speciality are relational because a rule is never 'general' or 'special' in the abstract but they are either 'general' or 'special' in their relation to some other rule. See para 111.

Personnel Landmines (Ottawa Treaty) is another example of a treaty being both *lex specialis* and *lex generalis* in relation to subject matter specificity. The Ottawa Treaty lays down general law on the use of landmines, and yet also a 'special' aspect of the general rules of humanitarian law.

Pauwelyn shed some light on the possible duplicity of the WTO as both *lex specialis* and *lex generalis* in relation to other treaties. According to him, to get around this problem, it was suggested that the WTO can be both *lex specialis* and *lex generalis* thus;

> An obligation to do something in events A to Z is *less specific* than an obligation *not* to do this something in events A and B. Or a WTO obligation *not* to restrict trade, *irrespective of the product involved*, must be seen as *less specific* than an obligation (or permission) to restrict trade *in the specific products A and B.* In that sense, the WTO's SPS agreement, dealing generally with all sanitary and phytosanitary measures, *irrespective of the product or health concern,* could be seen as less specific than, for example, the Cartagena Protocol on Biosafety which addresses certain specific products, such as 'living modified organisms', and deals with a specific health concern….[141]

This assertion proves to be very revealing as to how even a powerful treaty can be less effective in dealing with a specific area where its coverage of that area is too general compared to another regime with fewer parties but with particular focus in that area.

This solution runs the risk of inconsistency in treaty's identity when compared to another treaty in the event of an interpretation of a conflict. Even the substance of the agreement which is closest to the 'subject matter' of the agreement was debunked on the grounds that it is near impossible to decide substantively which agreement will represent general law, and which will represent special law, and that if these are possible, the outcomes will be unpalatable. e.g., it would suggest that regional regimes

[141] *Ibid,* at 389

on the same topic in comparison with universal regimes, would be the special law, but then, going by this thinking, NATO would be superior to the UN, while the EU would be automatically superior to the WTO,[142] and what we do not want to do is jump to those conclusions simply because Pauwelyn's analysis looks interesting or even credible.

2.8 **Conclusion**

These limitations even to the *lex specialis* principle when two *lex specialis* are in conflict proves crucial in appreciating the complex relationship between the WTO rules relevant to energy and the energy-focused regimes. While this discussion helps us understand the extent of the complexities which further goes to explain why a multilateral regime for energy is a tough sell, it becomes obvious that these theories alone does not get us answers to which of these regimes is more competent in governing energy. As progressive as the 'subject matter' solution is, we still need to look beyond it. It becomes imperative to rather consider a closer look at 'regime competence'. This takes the discussion from whether a regime is the *special law* to whether it is actually competent (or the appropriate regime) in dealing with trade and investment in natural resources. The way to determine competence is to examine the letter of the regimes in relation to what they seek to achieve, i.e., the wordings in their legal constructions.

Although regulation of trade and investment in oil and gas lie mainly with national laws and policy, states are for a large part influenced by norms that have their foundations in international law. The normative construct of the WTO/GATT rules applicable to energy hardly absorbs the economic realities and practicalities of oil producing States.

[142] See Jan Klabbers, *supra* n 116 at p.199

The question of which regime or institution between the WTO and energy-focused international institutions is most effective in addressing these economic realities and practicalities is both a legal and policy question. Therefore, in addition to the legal instruments establishing all the regimes, there is also the question of policy space allowed by international law for states to regulate oil and gas trade and TRIMs from the confines of their borders.

3

Legal Characters and Regulatory Competence between WTO rules relevant to energy and the ECT, OPEC, UN Res. XVII, and National laws

3.1 Introduction

> *The picture (of the controversial issues relating to the status of energy in international law) is one of fragmentation with multiple instruments involved. The bulk of regulation comes under domestic law and the role of regional and global law in addressing energy and secure production and supplies has remained unclear and unsettled. Doctrines of multilayered governance have hardly been applied to the sector.*
>
> - Thomas Cottier, *et al*[143]

With the recent arguments over the sustainability of OPEC's influence on the world stage;[144] the viability of regional management of energy transit;[145] and the nationalistic character of national legislation of resource management,[146] the issue of regime competence in the management or governance of energy resources is crucial to a discussion on whether the multilateral trade regime can deal with the trade effects of border measures and TRIMs in the oil sector *vis-a-vis* the gas sector. Oil and gas have never been governed by a single regime as explained in chapter one. OPEC's domain is oil, ECT's domain is transit in oil and gas. National laws' domain is both – depending on the state's resource. State-wise, Saudi Arabia is to oil as Russia is to gas. And the WTO's domain is goods generally, including oil and gas.

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[143] Cottier, T., 'Energy in WTO law and Policy'. WTO Publications

[144] The emergence of shale oil in the US, and the increase output in non-OPEC oil production (e.g., the US as a potential largest oil producer in 2015)

[145] Leal-Arcas R., *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance* (Edward Elgar, Cheltenham, 2011).

[146] The local content requirement in investment in the petroleum industry

Notably, the complexities involved in the oil market and oil trade (pricing and transportation) is fundamentally different from the way the gas market and gas trade works. Putting these in context *vis-à-vis* the way the WTO operates, it is common knowledge that normative values and obligations of the relevant WTO Agreements (GATT and TRIMS) is arguably not in sync with how these industries work. This chapter seeks to expand and compare the legal character of these institutions in relation to each other.

3.2 <u>**Regime Competence in governance of 'resource access'**</u>

In natural resources, the competence to manage, regulate, or govern goes beyond a state and the Union to which it belongs. It stretches across the boundaries of the international community. The 'competence' question in this regard is a question of which regime between energy producing states' domestic regulatory regime; or OPEC as a producer-only association and product specific treaty; or the ECT as an energy sector-specific trade and investment treaty; or the GATT/WTO comprising of states with inclusive interests over trade in all goods irrespective of origin, is most competent to govern trade and investment in these oil and gas. And since the measures undertaken under the auspices of these regimes all reinforced by the UNGA Resolution 1803, which recognises states' inherent right over natural resources, it is also a question of whether The Resolution enacted by the UN being an open institution should be given priority over the WTO even though The Resolution is not a treaty but a general principle of international law. This is an important question since generally speaking, treaties prevail over general principle of international law. [147]

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[147] See Keohane, R.O and Nye, J.S., '*Power and Interdependence*' (Boston; Little Brown, 1977) for a brilliant discussion on the categories of regime into *restricted instituitions, conditionally open institutions, and open*

While the WTO's developmental objective is aimed at opening up trade in goods and services to all Members (which is open to global membership subject to accession) as an **inclusive** community, the non-WTO regimes are aimed at the developmental objectives through trade restrictions that benefits parties to these regimes either **exclusively** i.e., for individual nation states (customary international law principle under UN Resolution on PSNR),[148] or **exclusive** for producer-only states (OPEC)[149] and **partially inclusive** for a wider range of states within a region (ECT regime). The implication of this is that since the Multilateral Trade Agreements, which are integral parts of the WTO Agreement including the provisions of the GATT, are given binding force and applicable to all Members,[150] measures implemented pursuant to norms arising from the non-WTO regimes would certainly not be in the manner prescribed by the WTO, and so the problem of non-compliance with WTO obligations conflicts over which norm is most competent to govern energy-related measures arises.

There is the view that international energy policy exhibits multilateralism due to the overlapping interests between producers and consumers and the strong need for energy co-operation as a result. [151] Then a discussion on whether a global interest or a regional

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institutions. The rationale and life of *Restricted Institutions* such as OPEC, NATO, OECD, and EC is built on their common interest, and are designed to achieve gains *vis-à-vis* non-members and to foster community bond amongst members to safeguard that common interest, including through *cartelization.* Conditionally open institutions such as IMF, the GATT are designed to promote global collaboration through adherence to non-discrimination and reciprocity as a price for admission together with its economic benefits, while Open institutions such as the UN are designed to promote exchange of opinions and fosters consultations for global actions, but due to its lack of formal rules and enforcement, it is not effective at compelling collaboration.

[148]Paragraph 1 and 2 of the UN Resolution on PSNR.

[149]Article 2 (a) (b) and (c) OPEC Statute.

[150]Article II (1) of the Marakesh Agreement establishing the WTO which defines the scope of the WTO.

[151] See Lars, A., *Trade and Energy: Investment in the Gas and Electricity Sectors* (Cameron May, London, 2004) at 41. This research distinguishes this reference to multilateralism which is in respect of policy interests, from exclusiveness of producing states' measures which is a matter of management control to safeguard their interest.

interest or producers' interests should weigh on our minds more is also an important one to have.

Arsanjani brought depth to the discussion on regime competence in the management of renewable natural resources which she categorised as 'internal resources'. She extensively examined the models, characteristics, and choice between *exclusive competence* (i.e., national standards and regulatory prerogatives in the management of internal resources) arising from *exclusive interest* of national governments over these resources, as well as OPEC as an exclusive group; *inclusive management* (i.e., an international legal order in the management of internal resources) arising from the *inclusive interest* of the international community, and *partially inclusive competence* (an international but sectorial and producer-only group in the management of internal resources) arising from the *inclusive interest of such groups or union*[152] (i.e., the EC).[153] However, she limits this brilliant description of competences to the pricing regime alone.

The author rejected both the claims that because non-renewable resources are internal resources only exclusive management is the competent authority; and that because the exploitation of these internal resources have extraterritorial, welfare and security of supply concerns for global players, only an inclusive management is essential if the inclusive economic interests of global players were to be safeguarded. Rather, she proposed the <u>use of constructive international agreements and practices that aims to</u>

[152]*Ibid* at 480

[153]Since OPEC's influence is universal, yet tailored to safeguard the interest of a few states, and since the ECT is sector specific over what is a globally interdependent resource, yet tailored to meet the demands of the European energy market, then these are typical examples of *partially inclusive competence* in the management of energy resources

promote systemic intercourse and cooperation, which she calls the 'constitutive process'.[154]

However, the crux of her argument was that since the principal features of the present constitutive process (at the time till date) are inadequate to meet the urgent need for unified management of resources, such constitutive process creating a single policy and institutional practice for all major players in the process of resource production is not a feasible one, especially as the constitutive process for non-renewable resources have not been responsive.[155] This position has gained scholarly support with **Gabriel Alberto** who further made the case for bilateralism as the only platform on which negotiation can thrive.[156]

This concepts of 'management competence' was also reflected in and explored further by the scholarly contribution of **John Jackson** where he tackled the concept of allocation of power in a constitutive process between the GATT/WTO as a component of international economic law regulating economic relations and its relationships with both non-WTO international institutions and nation states as channels of national sovereignty

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[154]*Ibid*, at 8. The literature examines past and present constitutive processes in the allocation of resources and proffers policy-oriented approach to arriving at solutions to conflicts that arise from management regimes by striking an appropriate balance between exclusive and inclusive competence. Her work reviewed how and for what purposes allocating agreements have been made, whether past practices have promoted the inclusive and exclusive use of resources, and how effective these agreements have been for the promotion of international policies.

[155]*Ibid* at 14

[156]Gabriele, A., '*Trade in Energy goods and Services in the XXI Century' in* Noah B. Jacobs (ed.) *Energy Policy: Economic Effects, Security Aspects and Environmental Issues* (Nova Science Pub Inc, 2009) at 243. Whilst the author agrees that such constitutive process is unfeasible by revisiting the reasons why the Doha Negotiation Rounds on Trade in Energy Goods and Services collapsed, he supported the strengthening of the now-prevailing trend towards bilateralization and the strengthening of the role of nation states in the energy sector. According to him, these were the likely outcome of the failure of the Doha Rounds at multilateralization of the sector being that the sector is strategic and traditionally state-intervened and heavily regulated.

wherein these economic areas are regulated.[157] This view re-echoes **Chayes**' 'New Sovereignty' concept whereby without disregard for traditional sovereignty, states can use their sovereignty to engage in constructive dialogue rather than a hard-line approach to fulfilment of treaty obligations.[158]

In situations where several regimes may be applicable to the same subject matter, interpretative rules on hierarchy alone may not be a sufficient tool in discerning practicality and viability of a regime. The concept of 'regime/institutional competence' becomes a more plausible route to take. Where there are conflicting regimes, a regime's competence to govern a particular area may be found in its legal and operational structure, explicitness, decision-making procedures, and the obligatory compliance it is able to impose on its subjects; all of which gives it normative authority.[159] This normative authority of a regime is particularly embodied in its objective provisions, which can be ascertained by its title, preamble, provisions and negotiation history.[160]

It has however been observed that even where a regime may not have all the trappings of a more structured regime with assertive obligatory prescriptions and strong obligatory compliance enforcement mechanisms, it can exert compliance based on the depth of collective political and economic interests shared by members or signatories to

[157]Jackson, J., *Sovereignty, the WTO and Changing Fundamentals of International Law* (Cambridge University Press, 2006). From his intimate knowledge and extensive analysis of the successes and challenges of the GATT/WTO in the constitutive process, he came to the conclusion that power should not completely tilt either in favour of or against international approaches, but rather, a harmony between politics and economics that breeds international 'good governance' should be envisaged in the future.

[158]Chayes, A., and Chayes, A.H., *The New Sovereignty: Compliance with international regulatory agreements* (Harvard University Press, 1998)

[159] Kratochwil, F., '*Contract and Regimes: Do Issue Specificity and variations of Formality Matter?' in* Regime Theory and International Relations (Volker, R., ed., Oxford University Press, 1995) 73-93

[160] Van Damme, Isabelle, '*Jurisdiction, Applicable Law, and Interpretation*', in Betlehem, Daniel, [et al.] (eds.): The Oxford Handbook of International Trade Law (New York: Oxford University Press, 2009) at 330-331

that regime. e.g., NATO, OPEC, OECD.[161] In fact, interests, rather than prescribed law, have been classically identified as the main driving force behind States' compliance with norms.[162]

However, this position was still met with the counter argument that international law, regardless of interests, is still more effective in achieving cooperation amongst sovereign states rather than legislating sovereign states through prescribed law.[163] The thinking behind this view is that prescribed state laws caters to states' interests and that alone may not necessarily yield competence if the principles of international law on international cooperation is not served. All of these and a few other elements make up the legal character of a regime.

3.3 **<u>OPEC Statute vs The WTO Agreement</u>**

Of the three non-WTO regimes relevant to the natural resource sector covered by this research, while the ECT discreetly poses the biggest threat to the WTO as will be seen later on in this section, OPEC is the most prominent in terms of normative conflict with the WTO. The debates concerning whether OPEC's production restriction measure is

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161 Keohane., Robert. O., '*The Analysis of International Regimes: Towards a European-American Research Programme*'

162 See Henkin, L., *How Nations Behave* (2nd ed., 1979) 22-27. Governments have been observed to act consistently with norms or obligations only when it is in their interest to do so and not because the law governs their actions to comply. This long-held presupposition, which to a large extent holds true even today is borne by the notion that international law is not law *per se* since law governs society and international society is not really a society, but a world comprising of a collection of sovereign states.

163 Henkin, L., *ibid.* at 26. This argument interestingly states thus: "*What matters is not whether the international system has legislative, judicial, or executive branches, corresponding to those we have become accustomed to seek in a domestic society; what matters is whether international law is reflected in the policies of nations and in relations between nations. The question is not whether there is an effective legislature; it is whether there is law that responds and corresponds to the changing needs of a changing society. The question is not whether there is an effective judiciary, but whether disputes are resolved in an orderly fashion in accordance with international law. Most important, the question is not whether law is enforceable or even effectively enforced; rather, whether law is observed, whether it governs or influences behaviour, whether international behaviour reflects stability and order*".

tantamount to quantitative restriction to bring it within the scope of the WTO is rife as earlier noted. OPEC had been singled out by the US for a legal challenge against its policy on the basis that it violates Article XI:1 of the GATT.[164] The issues surrounding this suits were complex for the US as will be seen, and their relationship of conflict stands out. This section compares the differences in their legal form and structures, their scope of influence and competence in the petroleum sector, the weight of their binding force to instil compliance on members, consequence following breach or non-compliance, as well as areas of inherent conflicts.

3.3.1 Legal Form/Structure

The distinction between the WTO and OPEC's legal form sets the tone for their ideological differences as well. The WTO is notably the only international organisation that is open to global membership subject to accession, and comprising of every sovereign state worldwide that seeks to engage in trade in goods and services with the rest of the international community. Hence, its designate as a globally inclusive regime. The establishment of the multilateral trading system led to the enactment of the GATT in 1947, and was further strengthened structurally in 1994 with the 'Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations'[165]. This broadened its scope on liberalisation of international trade by the introduction of more economic coverage and the establishment of the WTO which was vested with the mandate of

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[164] See discussion on 3.3.6

[165] The *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations* (Marrakesh, 1994); 33 ILM 1140 (1994)

overseeing the GATT of 1994 (i.e., the GATT of 1947 as amended) and the other Agreements peculiar to various sectors of the global economy.[166]

The WTO Charter has four important *annexes.*[167] The organizational structure of the WTO ranks from the 'Ministerial Conference' at the top[168], four 'Councils'[169], and the establishment of a 'Dispute Settlement Body' (DSB). All of these arms of the WTO facilitate the five mandates of the WTO spelt out in Article III (1)-(5) of the WTO Agreement in ensuring the principles of free trade and competition policy.[170] Decisions are reached by consensus at the Ministerial Conference and the General Council where one-country-one-vote is operative. However, when consensus cannot be reached, decisions will be based on the majority votes.[171] Once there's a consensus following negotiations, it becomes a rule under the WTO and therefore binding on all member states.[172]

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[166] See Jackson J. H., The WTO 'Constitution' and Proposed Reforms: Seven 'Mantras' Revisited, 4 *J. INT'L ECON. L.* 67, 68, (2001) at 68- 69. See generally WTO, Understanding the WTO, http://www.wto.org/english/theWTO_e/whatis_e/tif_e/tif_e.htm (last visited December 21, 2013.

[167] Annex 1A which is termed the 'Multilateral Trade Agreements' introduces the other Agreements relevant to trade in goods; Annex 1B on Agreements on trade in services, Annex 1C on intellectual Property; Annex 2 on Dispute Settlement Rules; Annex 3 on Trade Policy Review Mechanism (TPRM); and annex 4 on Agreements on Trade in Civil Aircraft, Government Procurement, International Dairy Agreement, and International Bovine Meat Agreement; and subsequently addressed other Agreements relating to agriculture, investment, services, subsidies, etc.

[168] Comprising a representative from every member state, and which meets once every two years

[169] The General Council with overall supervisory authority which can also carry out the functions of the Ministerial Conference; the Council for Trade in Goods (GATT), Council for Trade in Services (GATS), and Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS)

[170] Article III of the WTO Agreement spells out the five functions of the WTO to include: (1) to administer and implement the multilateral and plurilateral trade agreements that together make up the WTO; (2) to act as a forum for multilateral trade negotiations; (3) to administer arrangements for the settlement of disputes; (4) to review national policies; and (5) to cooperate with the IMF and the World Bank towards a greater coherence in global economic policy-making.

[171] A majority vote would see developed countries outvoted by developing countries since developing countries make more than two-thirds of the WTO Membership.

[172] For a general understanding of the legal character of the WTO, see: Blackhurst, R., *The Capacity of the WTO to fulfil its mandate, in* Krueger, A.O., *The WTO as an International Organisation* (University of Chicago Press, Chicago, 1998) at 31-57; Jackson, J.H., *The World Trade Organisation: Constitution and Jurisprudence* (Chatam House Papers, London, 1998) at 36-50; Qureshi, A.H., *The World Trade Organisation: Implementing International Trade Norms* (Manchester University Press, England, 1996) at 1-146; Hoekman, B.M., and

OPEC on the other hand is also an established international organization with membership restricted to petroleum exporting countries with considerable commercial quantity of petroleum resources. OPEC members account for about 40% of the world oil production and controls more than 81% of world proven oil reserves with about 66% of that total situated in the Middle East.[173] Unlike the WTO which gains membership by negotiation, OPEC's membership can only be achieved by invitation, and invitation is determined by commercial production capacity. Being a producer-only intergovernmental organization, OPEC sits as a forum for members to co-ordinate their policies as prescribed by the OPEC Statute.

OPEC's policy is centred around the coordination and unification of petroleum policies of its member countries through the restriction and increase in production of petroleum principally aimed at the balancing petroleum price more than anything else. This objective highlights the disputes over oil prices between producing countries and US government and oil companies. Initially, fiscal issues such as oil taxes and royalties were the focus of the US and oil companies. But after they shifted this focus to oil pricing, oil-rich developing countries on the platform of the OPEC Resolution XVI.90 of 1968 formed a common agenda of taking over foreign-owned operations, influencing oil price through production restriction, as well as the tacit objective of acreage access restrictions

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Mavroidis, P.C., *The World Trade Organisation: Law, economics, and Politics* (Routledge, New York, 2007) at 14-60; Cass, D.Z., *The Constitutionalization of the World Trade Organisation: Legitimacy, Democracy, and Community in the International Trading System* (Oxford University Press; England, 2005); Jackson, J.H., *The Jurisprudence of GATT & the WTO: Insights on Treaty Law and Economic Relations* (Cambridge University Press, England, 2000); Mitsuo, M., Schoenmaum, T.J., and Mavroidis., P.C *The World Trade Organization: Law, Practice, and Policy* (Oxford University Press, England, 2nd ed., 2006)at 6-14; Jackson, J.H., *The World Trading System: Law and Policy of International Economic Relations* (The MIT Press, Cambridge, Massachusetts London, England, 2nd. Ed., 1997) at 58-78.

[173] See *OPEC share of World Crude Oil Reserves 2012* at http://www.opec.org/opec_web/en/data_graphs/330.htm (last visited July, 2013)

such as ring fencing to international oil companies; a practice that was prevalent among the Middle East OPEC countries.[174]

A key aspect of this volume of power is its decision-making process which is on a one country-one vote basis requiring a unanimous agreement made in the OPEC Conference.[175] The unanimous decision of the Conference becomes effective 30 days from the vote, and each member state is expected to implement such unanimous agreement at their domestic levels. Where all (or most)[176] comply, the outcome on world oil price becomes immediately felt globally. Its membership base is such that it exhibits character of membership by differentiating between full members and associate members.[177] More so, OPEC was designated alongside the WTO, the status of a '*specialized economic organization*'.[178] What this means is that the WTO is a *lex specialis* for trade in goods and services, OPEC is a *lex specialis* for trade regulation of petroleum.

3.3.2 Scope and Competence

The scope and competence of the WTO and OPEC are embodied in the Agreement establishing the World Trade Organization (WTO Agreement) and OPEC Statute

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[174]*Waelde, T.,'International Organisations in the Energy Sector, OPEC' in* OGEL (2003). Available at http://www.ogel.org/article.asp?key=86.
[175]Articles 11 (c) and 15 (1) of the OPEC Statute. Decisions of OPEC are made by the Conference comprising of delegations representing each member states.
[176] There have been several cases of non-compliance and in fact measures taken to the contrary by some member states
[177] *Waelde, T., supra.*. Although the author may have stated that the formal OPEC decision on production quota is 'binding on member states', there is no known structural supranational body set up by OPEC to enforce quota decisions. Neither is there a punitive system for defaults in place. While states usually comply due to the overall economic benefit they derive from quota restriction, it is not unheard of that states, regardless of OPEC decisions, still engage in solo production above the mandated quota limit.
[178]Voitovich, S.A., *International Economic Organization in the International Legal Process* (Kluwer, 1995) 21-33, at 21

respectively. The mandate and competence of the WTO is prescribed in various multilateral and plurilateral agreements, and in this case, the General Agreement on Tariffs and Trade (1994) (GATT), the Agreement on Trade-Related Investment Measures (TRIMs Agreement) the Agreement on Subsidies and Countervailing Measures (SCM), and the Agreement on Government Procurement (GPA) are the most relevant to oil. Generally, WTO Agreement captures the general scope of the WTO. According to **Article II (1) and (2) of the WTO Agreement**: "*The WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement. The agreements and associated legal instruments included in Annexes 1, 2, and 3 (hereinafter referred to as "Multilateral Trade Agreements") are integral parts of this Agreement, binding on all Members".* This scope is expressed in Article XI of the GATT and which essentially prohibits all quantitative restrictions.

From Article II, the WTO's scope covers trade relations amongst member states 'in matters related to the agreements…' relating essentially to trade in every goods which is regulated by the GATT and other sectoral subsidiary instrumentals related to goods[179]; and trade in services which is regulated by the GATS and covering areas related to services;[180] all of which are integral part of the WTO Agreement and make up the Multilateral Trade Agreement. The implication of Article II is that if it is a commercial

[179] Besides the GATT, the other important subsidiary Agreements related to trade in goods include: the Agreement on Agriculture; the Agreement on Trade-Related Aspects of Intellectual Property Rights; the Agreement on Trade-Related Investment Measures; the Agreement on the Application of Sanitary and Phytosanitary Measures (The SPS Agreement); the Agreement on Technical Barriers to Trade; the Agreement on Subsidies and Countervailing Measures; The Anti-Dumping Agreement; and the Agreement on Safeguards.
[180] Movement of natural persons, telecommunications, financial services, air transport, and shipping.

good and cross border services covering movement of persons, telecommunications, financial services, air and shipping services, then it is governed by the WTO. This stretches to corridors of investment as it relates to the National Treatment principle under Article III of the GATT, to which the TRIMS Agreement is specifically dedicated. Such governance is given enforcement under Article III.

Article III:1 provides thus: "*The WTO shall facilitate the implementation, administration and operation, and further the objectives, of this Agreement and of the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration and operation of the Plurilateral Trade Agreements*".

Article III:1 is where the competence of the WTO to regulate 'all' trade relations in goods and services among Member States is explicitly spelt out.[181] The careful choice of the languages 'implementation', 'administration', and 'operation' reaffirms that regulatory competence. This WTO scope is safeguarded by the DSU (Dispute Settlement Understanding), which is noted to be one of the most important instruments designed to protect the security and predictability of the multilateral trading system within the WTO such that the DSU provisions "must be interpreted in the light of this object and purpose and in a manner which would most effectively enhance it".[182] In fact, 'security and predictability' of international trade has been recognized by a number of Panel and

[181] The problem here lies with the fact that different and competing forms of energy are subject to divergent international rules, depending on whether they qualify as a good or a service. For instance, whilst there are no disciplines on subsidies in services, even existing disciplines on subsidies in goods may not be suitable to address a distinction between renewable and non-renewable energy under GATT and the Agreement on Subsidies and Countervailing Measures (SCM Agreement).
[182] See *United States – Sections 301 310 of the Trade Act of 1974*, panel report circulated 22 December 1999, adopted 27 January 2000, WT/DS152/R, para. 7.75.

Appellate Body Reports as an object and purpose of the WTO.[183] The Panel in *EEC – Imports of Newsprint* captured this objective in unmistakable terms thus,

> "*The Panel shared the view expressed before it relating to the fundamental importance of the security and predictability of GATT tariff bindings, a principle which constitutes a central obligation in the system of the General Agreement*"[184] (*emphasis mine).*

This should presuppose that the guaranteed security and predictability of international trade should lie with the WTO.

Interestingly however, this competence can be similarly found in the OPEC statute.

Article 2 (a) of the OPEC Statute (to be read alongside Article 2(a) states thus;

> "*The principal aim of the Organization shall be the coordination and unification of the petroleum policies of Member Countries and the determination of the best means for safeguarding their interests, individually and collectively*"

Article 2 (b) then goes further to state thus;

> "*The Organization shall devise ways and means of ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations*".
> (*All emphasis mine)*

Article 2 (a) and (b) of the OPEC Statute goes to show OPEC's competence, which was set on course by its 'Declaratory Statement of Petroleum Policy in Member Countries'

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[183] *Japan – Measures on Imports of Leather*, panel report adopted 15/16 May 1984, BISD 31S/94, para. 55 where the panel implied that an essence of prohibition of quantitative restriction is to prevent increased transaction cost, which could lead to uncertainties that would affect investment plans; *EEC – Imports of Newsprint*, panel report adopted 20 November 1984, BISD 31S/114, para. 52; Norway – Restrictions on Imports of Apples and Pears, panel report adopted 22 June 1989, BISD 36S/306, para. 5.6; *Japan – Taxes on Alcoholic Beverages II*, Appellate Body report circulated 4 October 1996, adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (Japan – Alcoholic Beverages II) at 31; *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and other Items*, panel report circulated 25 November 1997, adopted 25 November 1997, WT/DS56/R (Argentina – Textiles and Apparel), para. 6.29

[184] *Ibid.*

incorporated in *Resolution XVI 90 of 1968.*[185] The implication of Article 2 (a) is such that the coordination of petroleum policies, even if it means production cut,[186] is channelled towards safeguarding the economic interests of members only, either individually or collectively. OPEC clearly and unequivocally presents how this is to be accomplished, and that is through an efficient, economic and regular supply of petroleum to consuming nations;[187] effectively putting absolute control of petroleum trade governance in OPEC and outside the WTO.

The implication of Article 2 (b) is that *"price stabilization"* has the same purposive effect of achieving "*security and predictability*"; a scope which the DSU arrogates to the WTO. However, it is fair to say this objective within OPEC is limited to trade in petroleum. But again, if petroleum qualifies as a 'good', thereby confining it to the WTO's mandate of security and predictability, then there is equal competence between OPEC and the WTO. This is likewise a clash of competence arising from an inherent conflict.

3.3.3 *The core beneficiaries*

Of the 193 sovereign UN Member countries around the world, as many as 159 countries (as of March 2, 2013) are privy and subject to the WTO Agreements with as many as 16

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[185] While OPEC Statute was designed to be a treaty code, the Declaratory Statement consisted of a set of broad guidelines laid down as basis for future policies in industry development, participation, tax reference prices, and conservation of hydrocarbon resources, and which was considered to be the most significant OPEC act of the first decade of its existence, and the one which would set the stage for later actions.

[186] Oil production cut is noted to be a major factor, if not the biggest factor, which has a ripple effect on world oil price besides externalities such as the global economic recession and recovery, natural disasters e.g in Japan in 2011, civil unrests in oil rich regions like the North Africa Arab spring and in the Middle East, have a ripple effects on world oil price, OPEC's production restriction is a major, if not the biggest, factor . See '*Oil prices rise after OPEC holds oil production*' 2011. Available at http://www.bbc.co.uk/news/business-13707254 .

[187] See OPEC: " http://www.opec.org/opec_web/en/about_us/24.htm

in the process of negotiating their accession. Going by this statistics, it is safe to say the WTO is a globally inclusive treaty whose principles of non-discrimination is designed to benefit every country. OPEC on the other hand does not have a global coverage in terms of core beneficiaries. With membership open only to countries with substantial net export in petroleum and with similar economic interests, it is unlikely a developed producing country like the USA will qualify as OPEC member state for the simple reason that it does not share economic interests similar to developing oil producing countries.

Although OPEC's policies are designed with member states' economic interest at the fore, from the wordings of Article 2 (a) of OPEC Statute, OPEC puts consuming nations into consideration since they would be impacted by its policy objective. What that means is, in the event of low petroleum market price, investment in petroleum exploration would be unattractive, and low investment will have a knock-on effect on security of supply, thereby forcing consuming countries to invest in technology towards alternative source of energy in the future. Since neither of these will be in the interest of producing countries both in the short term and long term, they respond to such extreme low price by cutting production, leading to artificial shortage whereby demand exceeds supply. The aim is to push price up and high prices would make for attractive investment. In OPEC's own term, such production cuts will "stabilize the price".[188]

[188] Never mind this claim, OPEC's production cut or increase is renowned to cause fluctuation in petroleum prices to the extent its economic interests are safeguarded. However, stability also means that they ensure the price is neither too low to the extent it sabotages their economic bottom-line, nor too high that foreign markets suffer so much from insecurity of petroleum supply. Technically OPEC sets price through (a) posted price: a mechanism used by exporters to calculate royalties and tax forms from companies who produce and keep the oil, (b) buyback price: Price applied to oil produced by the companies, but owned by exporters through participation agreements, then bought by the companies, and (c) open-market price: Price applied to participation oil not bought back or to oil sold on the open market. See Loumiet, '*Towards an International Commodity Agreement on Petroleum*' 5 DEN. Journal of International Law and Policy 513 (1975).

3.3.4 *Binding force (Legally Binding or Politically Binding)*

Both the WTO agreement and the OPEC Statute makes reference to 'obligations'. While the WTO Agreement generally prescribes obligations and thrives on the binding nature of its obligation on all Member State, Article 3 of OPEC Statute also clearly refers to requirements under the Statute as 'obligations'. **Article 3** provides thus: "…*Member Countries shall fulfil, in good faith, the obligations assumed by them in accordance with this Statute."* (*emphasis mine)*

If OPEC's objectives set out in the Statute as mentioned above are in the character of an obligation, then such obligation should be weighed side-by-side the same Member States' obligation under Article XI:1 of the GATT. On the surface, this situation is clearly a case of inherent normative conflict as defined by the strict definition in chapter 2, i.e., conflict between both obligations. It becomes imperative to determine the effect and weight of both obligations. Taking the text on OPEC's reference to obligation literally, the decision to cut production would be taken to be an actual obligation for all intent and purpose. Yet this is not the case as will be seen later in this chapter. A way to determine the weight of an obligation is to determine whether it is binding or not.

Unlike the WTO's obligation that are in the form of commands whereby the WTO DSB compels a defaulting state to bring its measure back to status quo, failing which it will attract retaliatory sanctions; OPEC's obligations on the other hand requires compliance on the basis of good faith. In a case where an OPEC member state with a *right* as a petroleum producer chooses not to comply with OPEC's directive since its obligatory standard is that of *good faith* and not a command, then the argument is that *there is no* *conflict at all.* But on the flip side, regardless of whether such a country chooses to comply or not, as long as it has the potential to comply based on its right to cut production, then there is a conflict in applicable law between OPEC Statute and the GATT.[189]

Even though OPEC is an international organisation, its member states do act independently and unilaterally as an expression of their sovereign will, regardless of directives by the OPEC Conference to collectively cut production.[190] A state's capacity to act (or not to act), is dependent on whether the state has the right or not. Whether that right originates from a principle of international law permitting it to act or from a principle not prohibiting it to so act is of secondary importance.[191] Therefore, OPEC is not structured to impose legally binding obligations on states. Rather the OPEC Conference may agree on supply limits without deposing individual states of their rights to act otherwise knowing fully well that states compliance is usually guided by their collective interest.[192] The decision by the OPEC Conference may qualify as a situation

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[189] See chapter two

[190] Unilateral acts have been classically defined as a unilateral legal transaction that creates international rights and obligations; in other words, all international legal transactions of a State other than treaties, consultations, and negotiations. See Sir Arthur Watts, *Oppenheim's International Law* (9th ed., Longman, London New York, 1992) p. 1187

[191] See Aleš Weingerl, '*Definition of Unilateral Acts of States'. The* author defines unilateral acts of states as '*international legal transactions representing legally recognized means of manifesting unilateral consent to be bound and creating, modifying, suspending or terminating international rights and obligations in accordance with international law*' p. 8. He however, admits this definition will attract stiff opposition.

[192] At a time, after the 3rd Conference in 1961 (Res. 111.26) OPEC sought to unify its production policy so that states could not produce or under-produce outside the mandate agreed by the Conference. But after ten years of difficulty in achieving this due to the stark differences in each members' economic levels, at the 21st Conference in 1971 (Resolution XXIII:133), OPEC resolved to shelve the idea on the premise that producing states will still act in compliance with OPEC resolution to restrict production especially when it is in their collective interest to so do. And while Saudi Arabia, Iraq, Iran, Venezuela, and Kuwait as the five major OPEC producing members adhered to the pricing regime, not to conform to these prices by other members would be detrimental to their competitiveness. See D. Rustow & J. Mungo, 'OPEC: SUCCESS AND PROSPECTS' 94 (1976) at 99. Also in 1986 OPEC identified and determined that the criteria for its quota systems be based on factors including reserves, production capacity, historical production share, domestic oil consumption, production costs, dependence on oil exports, population, and external debt. See Sandrea Rafael, '*OPEC's Challenge – Rethinking their Quota System*' (2003) 101:29 Oil & Gas Journal, 31-48

where, according to Heusel, an agreement is either morally binding or politically binding, but not legally binding. Such a classification is controversial but has gained some prominence.[193]

Conversely, there are dissenting views which argue that regardless of the form of an agreement, the mere substance of the agreement and the fact that they are entered into by competent political authorities as an expression of their common national policies gives the agreement a legal weight, and therefore legally binding. And that if they do not achieve this, then they are not legally binding and the distinction with them being 'politically binding' is useless.[194]

However, unlike the Atlantic Charter, two rather uncontroversial examples are the 'Document of the Stockholm Conference on Confidence and Security Building Measures and Disarmament in Europe' (SCCCBMD)[195] and the 1992 United Nations Conference on Environment and Development (UNCED) Declaration on forests.[196] It would therefore appear that the distinction between 'politically binding' and 'legally binding' norms are that even though not legally binding, politically binding norms have the usefulness of promoting political will and joint actions amongst states with similar interests, but which at the same time may not require a binding force.

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193 For a practical and theoretical distinction between legally binding and politically binding or morally binding agreements, see Wolfgang Heusel, '*Weiches' Volkerrecht* (Baden Baden 1991) at 46. An example of supposed politically binding agreement is the Atlantic Charter.

194 See McDougal and Lans, "*Treaties and congressional-executive or Presidential Agreements: Interchangeability Instruments of National Policy", in* Myres S. McDougal & Associates, *Studies in world public order (New Haven 1960)* at 404-717; Klabbers, J., *supra* at 123-126

195 26 ILM (1987), 191. This instrument is unequivocally a politically binding but non-legally binding instrument as explicitly stated in article 101 which provides that "the measures adopted in this document are politically binding…"

196 31 ILM (1992) at 882. This instrument carries the title- "Non-legally binding authoritative statement of principles for a global consensus on the management, conservation and sustainable development of all types of forests."

Unlike the SCCBMD and the 1992 UNCED instruments, OPEC Statute does not explicitly state an intention to be simply politically binding rather than legally binding. And unlike the WTO Agreement, it neither provides that it is intended to be legally binding on all Member States. Its non-binding nature is inferred from its obligations of *good faith.* Such expectation of good faith does not qualify as a strict obligation and therefore means that OPEC Member States have a political commitment rather than a legal one.

It is not clear whether 'politically binding' is a perfect term to describe OPEC Conference decisions, however, Thomas Waelde in giving credence to the political nature of OPEC acts suggested that the Western opposition to OPEC as the face of the New International Economic Order (NIEO) concept by developing countries was based on the fear over high oil prices arising from "politically motivated supply disruptions".[197] It is yet to be determined whether such politically motivated supply disruption therefore means they are politically-binding. Mikdashi suggested that OPEC members are rather guided by what appears to be a *moral commitment.* According to him:

> Their agreement on oil export prices is strictly voluntary, and does not carry with it sanctions or rewards. Moreover, the agreements leave to the discretion of each member government the setting and changing of prices <u>within a range considered reasonable by OPEC members</u>. A close scrutiny of OPEC's resolutions shows that the organization does not have supranational powers, and its resolutions are merely guideposts for action. Member countries do not delegate to any central body their decision-making powers. Indeed, they jealously guard their sovereignty, and consider their freedom of action to be paramount.[198]

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[197] Waelde, T., *Waelde, T.,'International Organisations in the Energy Sector, OPEC' in* OGEL (2003). Available at http://www.ogel.org/article.asp?key=86.

[198] Mikdashi, Z., The International Politics of Natural Resources (Cornwell University Press, 1979) at 77-78

Hence, in spite OPEC's non-binding effect, its *management competence* is undeniably potent- at least, so far.[199] For instance, the event of 1971-3 leading to the global '*Oil Shock*'.[200] Since then, OPEC has defiled all attempts at market liberalization and free trade in oil, or even earlier notions challenging its potency as an institution. [201]

Moreover, it raises the question as to whether a non-legally binding agreement can be legally justified. In questioning the hypotheses that morally or politically binding obligations may not be law simpliciter since they are not legally binding, Klabbers argues that even though they may not have the trappings of a legally structured treaty which are explicitly legally binding with enforcement mechanisms, the fact that they are agreements with consent between states gives them legal status as 'law' and not just a mere moral undertaking or mere political exhibition. He goes further to conclude that "a politically or morally binding agreement cannot exist unless it is also legally binding".
It is not clear whether OPEC fits this proposition, but such legal question is what has triggered the long-lasting debates as to whether OPEC is a cartel or not. This research does not occupy itself with that debate, but rather recognises that the attempted suits against OPEC by the US government in the US courts and under the WTO Dispute

[199] Several literatures, though divisive, enrich the discussion on the success story of OPEC's coordination of production limits and its influence on world oil price. Adelma, M.A., '*The clumsy cartel' in Energy Journal 1. (1980) at 43-53* makes the case that OPEC has kept oil price from settling at a low price, and has also kept oil price from being too high for too long. See also an extensive literature on OPEC's influence by Carol Dahl and Mine Yucel, '*Testing Alternative Hypotheses behaviour of Oil Producer behaviour' in Energy Journal 12. (1991)* at 117-138

[200] The oil production embargo declared by OPEC in October 1973 following America's support for Israel in the Yom Kippur war led to the oil shock of 1973 to December 1974. This was a global economic event where the price of oil quadrupled, thereby leading to an immediate negative economic effect across the developed importers and a positive economic effect for OPEC countries. Normalcy returned only after OPEC's suspended production cuts, following the withdrawal of Israel and the end of the war. See also: OPEC 'World Oil Outlook 2012'

[201] Tanzer, M., *The Political Economy of International Oil* (Maurice Temple, London, 1969). The author had argued that OPEC thrives on companies' willingness to make concessions, otherwise, OPEC's goals did not succeed.

Settlement Body- all to no avail, points to one reality: it is possible for an agreement to not have a legally binding effect on its Members yet outcomes of its decisions have global economic ramifications as an existing treaty. What has always mattered is that the decisions by individual OPEC Member States to increase or reduce production, whether through constitutional practice of parliamentary approval or by executive orders, is paramount. Therefore, the legal potency of agreements (or in this case- a treaty) is permitted by virtue of such constitutional practice of states, regardless of whether or not the agreement explicitly provides that it is intended to be a politically or morally binding agreement.[202]

In spite of OPEC's successes even though it is not structured to be binding, the same non-binding characteristics create scenarios that hints at the structural crack in the wall of OPEC's unity. There are recorded instances of competitive and confrontational practices amongst the big OPEC states either to outdo each other in gaining markets or to force another to comply with OPEC quota reduction.[203] Such recent tensions and diversions within OPEC members especially between Saudi Arabia and other key members has seen an increase in production even when OPEC decided otherwise, which

[202] Benedetto Conforti, *International law and the role of domestic legal systems* (Dordrecht, 1993) at 81.

[203] Saudi Arabia's competitive increase in production in 1997 to the US after initially failing to negotiate with Venezuela to reduce its production to the US; hence achieving a drop in oil price due to over production so as to inflict a revenue fall that would make Venezuela to eventually reduce production. Also, the 2011 production cap split between Saudi Arabia and 6 other OPEC members led by Iran, both of whom seek to wield powerful influence over the Middle East. A public meeting that was deadlocked on the issue of production quota led to Ali-Al Naimi, Saudi's Petroleum Minister's famous quote: "That was the worst meeting we've ever had". See The New York Times, '*Split by infighting: OPEC keeps a cap on Oil*', June 8, 2011. Available at http://www.nytimes.com/2011/06/09/business/global/09opec.html?pagewanted=all&_r=0 (Last visited April 28, 2013). Also, Iraq in 2009 challenged OPEC's production quota on the basis that its economic interest meant that its 2.5 million bpd was not sufficient to run its economy while it had auctioned some of its largest oil fields to Russian and Chinese companies to boost production by as much as 9 million bpd. See Business Insider. Available at http://www.businessinsider.com/iraq-will-rival-saudi-arabias-oil-2009-12 (last visited 28 April, 2013). And very recently in 2013, it threatened to leave OPEC if its interest is not considered. See Business Insider.

further underscores the narrative that the potency of OPEC may be in decline. This infighting has lots of times resulted in quota cheating amongst members. In addition, the production policies of non-OPEC but somewhat significant producers like Russia (10 percent of world production) and Norway (8 percent of world production), and less significant producers like Mexico (5 percent) and Oman (3 percent) sets out to inject competition to OPEC's bottom-line.

For instance, if a country like Russia that is not solely oil-dependent chooses to boost production at a time where OPEC is restricting production, such policy could sabotage OPEC's intentions since it may serve to ease high oil price triggered by OPEC's production restriction. Also, while we have seen OPEC countries renegotiate their relationships with IOCs, the opening of foreign investments to IOCs by other notable OPEC countries such as Iraq, Libya, and Algeria as well as smaller OPEC states like Gabon had been seen as a source of concern for OPEC since such open door investment policies was perceived to give IOCs influence on production outcomes.

These strengths and shortcomings of OPEC becomes even more intriguing considering that of the current 13 OPEC member states, 9 are already WTO members with Saudi Arabia, the biggest OPEC member being the most recent WTO member. More so, the remaining 4: Algeria, Iraq, Iran, and Libya are currently having an observer status. While this may tacitly infer that OPEC members may not be completely averse to a multilateral trade regime in petroleum, there is no evidence to support that as conclusive.

3.3.5 *Legal consequence following breach*

In terms of the relationship between the WTO normative force and that of OPEC, failure to comply with WTO obligations attracts a further obligation on the offending state to perform both restitution to bring its measure in line with its WTO obligation before the violation, and reparation to compensate the injured state for loss. But it also attracts punitive consequences in the form of retaliatory sanctions whereby injured states or other third party states can gain the right to take counter measures against the offending state should it fail to comply with the obligation to restore things back to *status quo* or compensate. With OPEC enforcements are non-binding. More so, there is no enforcement mechanism.[204] Rather, compliance is based on either good faith of member states, the economic repercussions of non-compliance on their revenue, or by pressure from influential members.

At best, OPEC monitors the implementation of Resolutions by member states through the Enforcement Department of the Secretariat. This alone may undermine OPEC's normative force. However, it is also doubtful, at least so far, that a state will be dragged before the WTO dispute settlement purely on implementing OPEC's production quota directive.[205] Unlike with quantitative export restriction which is a direct trade measure and which is explicitly prohibited under Article XI of the GATT, 'production restriction' which has an indirect effect on export may not clearly be in violation of Article XI even

[204] See discussion on the binding nature or otherwise of OPEC Statute in previous section above

[205] In spite of this difficulty, the US has been an ardent campaigner against OPEC. Senator Frank R. Lautenberg has been at the forefront. In 2004, he called for the DSS to declare OPEC's production quota a gross violation of Article XI of the GATT. See http://www.lautenberg.senate.gov/documents/foreign/OPEC%20Memo.pdf. And in 2008, he introduced a bill that would force this action by requiring the US Trade Representative to initiate consultations with countries with OPEC and WTO membership, and if consultations fail, then the US would request that a dispute settlement panel be set to decide on the legality of OPEC's production quota.

though the 'determination of production levels' is said to represent a major issue affecting oil trade.[206]

3.3.6 *The genesis of attempts at suing OPEC*

The core of the OPEC/WTO conflict is whether OPEC's production restriction is in violation of Article XI:1 of the GATT. For OPEC's production restriction to be found inconsistent with the WTO rules, OPEC first has to be sued. This has been difficult, if not unfeasible- at least so far, for the simple reason that OPEC is not a sovereign state but an intergovernmental organization made up of sovereign states. Only States can be sued before the WTO dispute settlement body- either individually or jointly. Since OPEC is not a sovereign State, the challenge was to sue all the OPEC countries. This posed the problem of joinder of the right parties. For parties to be joined to a dispute, actions warranting a complaint have to be attributable to them directly. For all the OPEC countries to be sued, they had to be detached from the umbrella-OPEC first, then sued individually. And since production restriction has to be attributable to a State, it was near impossible to sue all the States at once. Another reason is that there is no treaty governing international competition law. Rather, antitrust issues are tackled at national levels by countries with strong antitrust laws.

The most ardent opponent of OPEC has been the US, which has a robust antitrust law. This difficulty played out in several suits filed against OPEC in US courts under US

[206] Jimenez-Guerra *The World Trade Organisation and Oil* (2000) p. 32

antitrust law.[207] The established precedence from these suits is that the US antitrust laws do not apply to sovereign decisions taken by OPEC member on the grounds that OPEC measures as foreign sovereign measures are outside the US courts' jurisdiction under the doctrine of 'foreign sovereign immunity' and the 'act of state' doctrine.[208] Subsequently, US Congress floated another round of Bills and Resolutions to still bring a suit against OPEC in the US courts under its antitrust laws, but this time, calling for the abolishing of 'Foreign Sovereign Immunity Act' and the 'Act of State' defences which were barriers to their chances of winning the initial suits. These suits were still unsuccessful.[209]

There had also been a history of antitrust challenge against OPEC by other countries under their antitrust laws as early as the 1970s.[210] Following the failure of antitrust suits against OPEC in national courts, the US changed strategy and rather sought to bring a suit against OPEC right before the WTO through a bill introduced by Senator Peter

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[207] *International Association of Machinists and Aerospace Workers vs OPEC and Member Countries* (1978) 477 F Supp 553 (CD Cal 1979); *Prewitt Enterprise, Inc v OPEC,* 2001 US DIst LEXIS 4141; 2001-2 Trade Cas (CCH).

[208] For a comprehensive examination of the US antitrust suits filed against OPEC, See Desta, M.,'*OPEC Production management practices under WTO Law and the Antitrust Law of Non-OPEC Countries'* (2010) *infra* at 455-459

[209] S. 665, No Oil Producing and Exporting (NOPEC) Act of 2000, 107th Cong., 1st Sess.; H. Con. Res. 276 (Mar. 13, 2000)(strongly urging President to file WTO complaint against OPEC member nations for unlawfully imposing quantitative restrictions in petroleum exports); H.R. 4732, International Energy Fair Pricing Act of 2000, 106th Cong., 2nd Sess. (June 23, 2000)(requiring review of all US programs to determine if aiding OPEC and eliminating such aid); S 2182, Oil Price Reduction Act of 2000, 106th Cong. 2d Sess. (Mar. 6, 2000)(eliminating us foreign aid to OPEC nations); H.R. 3822, Oil Price Reduction Act of 2000, 106th Cong., 2d Sess. (Mar. 2, 2000)

[210] For a comprehensive outline of the history of attempted antitrust suits against OPEC, see Spencer Weber Waller, '*Suing OPEC'* 64 U. Pitt. L. Rev. 105 (2002)

DeFazio in 2004.[211] The most recent is the 2008 'OPEC Accountability Act' by Sen. Frank Lautenberg.[212]

A major component of the *Lautenberg Report* was that it required the US Trade Representatives to initiate consultations with countries who are members of both WTO and OPEC, and where the consultations fail, that the US would request the WTO to convene a dispute settlement panel to find OPEC member countries' production restriction in conflict with their obligation under Article XI:1 of the GATT. This bill was also unsuccessful on the grounds that OPEC production management was, even though arguably a restrictive measure, was in line with the principles of PSNR contemplated by international law as a principle of customary international law, and so outside the scope of the WTO.

3.4 **National Laws Vs The WTO Agreement**

3.4.1 *Governing competence over Trade-Related Investment Measures*

While the quantitative restriction provision may point to the GATT as an instrument that governs border measures alone, and since border measures are primarily tariffs and quotas, it has been argued that the WTO should return to its traditional GATT scope and focus.[213] However, Article III of the GATT which prohibits the use of internal laws and

[211] (H R 4780), 108th Congress, 2d Session (8 July 2004) introduced by Congressman Peter DeFazio (A Bill urging that the United States file a complaint in the World Trade Organization against oil-producing countries for violating their obligations under the rules of that organization. There was no roll call vote for this Bill. See http://beta.congress.gov/bill/108th-congress/house-concurrent-resolution/290 (Last visited 18th August, 2013)

[212] Bill introduced to take action against OPEC for its anti-competitive practices. See http://votesmart.org/public-statement/339413/lautenberg-introduces-bill-to-take-action-against-opec#.Uh1kndKRCSo (Last visited 15 August, 2013)

[213] Barfield, C.E., '*Free Trade, Sovereignty, Democracy*' (AEI Press, 2001) at 37-69; Jeffrey L. Dunoff, '*The Post-Doha Trade Agenda: Questions About Constituents, Competence and Coherence*', *in* Ross P. Buckley, ed., *The WTO and the Doha Round: The Changing Face of World Trade* (Kluwer Law International, 2003) 59.; Guzman, A.T., '*Global Governance and the WTO*' *Harvard International Law Journal* 45 (2004) 303.

regulation in a way that gives advantage to local producers over imported goods stretches the GATT scope to also include 'behind the border' measures that ultimately have trade effects. Other WTO Agreements also extends the WTO coverage to include non-tariff barriers to trade.

But questions have been raised as to whether the WTO has the adequate capacity or tool to handle 'behind the border' resource-related issues, with particular attention drawn to its lack of competition policy or antitrust rules, investment rules, and environmental rules.[214] This does not deny the relevance of Article III GATT outright where it relates to competition and investment. But in spite of Article III:4 GATT and Article 2 of the TRIMS, the fact that local content requirement being a behind the border trade-related investment measure still thrives does raise questions about the 'state compliance' element in the definition of international regime, and state compliance is relevant in determining whether a regime is competent in a particular area.[215] It may then follow that since states do not necessarily comply with Article III:4 or Article 2 of the TRIMS when it comes to regulation of oil and gas, then the assumption is that the WTO is not the competent regime to regulate the behaviour of states in relation to behind the border measures in the energy sector.

3.4.2 *Governing competence over border measures*

States by their sovereign identity are competent in governing border measures. However, by accession to the WTO that capacity (not sovereignty), as we will see later

[214] Jackson, J.H., *supra* n 157 at 131-132
[215] See definitions by Wolf, K.D., and Zurn, M., and Keohane, R.O and Nye. *Supra* n. 147

in the discussion on the WTO rules versus the UNGA Resolution on PSNR, may have been renegotiated thereby requiring States, irrespective of their sovereignty, to conform to the objectives of reciprocity and free trade under the GATT. But as has been established in Chapters 1 and 2, natural resource producing states (oil and gas producing in this case) seem to play by a different set of rules when it comes to their resources, and this trend has lingered in spite of their WTO membership. The competence of the WTO rules applicable to energy weighed against national laws on export quota and export restriction measures is noticeably fragile.

3.5 The Energy Charter Treaty Vs The WTO Agreement

3.5.1 *Legal Form/Structure*

Both the WTO and the ECT are multilateral treaties. The governing body of the ECT known as the Energy Charter Conference comprises of representatives from all member states. The Energy Conference deliberate on matters to promote energy cooperation amongst member states; the framework for implementation of the treaty provisions; and the consideration of new instruments for future actions within the charter framework.[216] In other words, decisions of the charter are deliberated and made by the Charter Conference following advisory reports from its subsidiary bodies responsible for each of the Charter's functioning arms.[217] By implication, the ECT is transactional even though written in the language of states being a treaty just as with the WTO and OPEC. The capacity to make decisions applicable to member states points to the ECT's

[216] See generally, Article 34 ECT.
[217] Investment Group, Trade & Transit Group, and Working Group on Energy Efficiency and Related Environmental Aspects. There's also the strategy group, Budget Committee and Legal Advisory Committee.

perceived competence in governing energy trade and transit. We examine the scope and competence in comparison with the WTO in more detail below.

3.5.2 *Scope and Competence*

Whereas the WTO is global in scope covering all goods, the ECT is somewhat regional in scope- albeit with a global appeal.[218] The majority of its members are within the Eurasia region (with the exception of Australia and French Guiana- a microcosm of France but located in South America). But more importantly, it is sector-specific covering energy cooperation in relation to investment protection, trade, transit, and energy efficiency. Therefore, it passes as both an investment protection regime and a transit mechanism for grid-bound energy trade across the territory of other states.

Although the ECT rules likewise apply to trade in oil, when ECT regime is being discoursed, almost certainly the issue is about gas. An explanation for this is that ECT member states are not as oil rich. The ECT prescribes its competence in its 'purpose of the treaty' provision.[219] The ECT's scope shows similarities with and improvements to the WTO. In terms of their similarities, the ECT is widely regarded as a treaty that complements the GATT especially on matters relating to internal taxation, discriminatory and non-discriminatory trade restrictions in ways that suggests the spirit of both regimes are intrinsically similar. Where there may be overlaps, the drafters of

[218] Signed in Lisbon, Portugal on 17 December 1994 and entered into force in April 1998. Although the signatories to the ECT are countries within Eurasia, the ECT has a global appeal. It has 9 observer countries, 16 observer countries by invitation, and has relationship with an increasing number of energy-based international organisations including the WTO, CIS Electric Power Council, the Organisation for Economic Co-operation and Development (OECD), the International Energy Agency (IEA), and others including the Association of South-East Asian Nations (ASEAN), World Bank, EBRD, and UN- ECE

[219] **Article 2:** This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.

the ECT saw the need to ensure that compliance with the ECT provisions does not make Contracting Parties deviate from their obligation under the WTO.[220] One can say that although investment protection is a core focus of the ECT, it similarly applies the tenets of the WTO – albeit at a sectorial level. Because of its specificity, the ECT is one treaty regime that qualifies as a credible threat to the WTO.

Like the WTO, the ECT applies the Most Favoured Nation principle to cross-border energy trade; the National Treatment principle on internal market to the single energy market within Europe;[221] the elimination of restrictions on transit and investments[222] subject to exceptions;[223] and special provisions akin to the WTO model to resolve inter-state trade disputes.[224] Coop Graham summarised the scope of its application thus, "*The Charter represents a political commitment to co-operation in the energy sector, based on the principles of development of open and efficient energy markets; creation of conditions that will stimulate the flow of private investments and the participation of private enterprise; non-discrimination among participants; respect for state sovereignty over natural resources; and recognition of the importance of environmentally sound and energy-efficient policies.*"[225]

Meanwhile, where the GATT's provision on pipeline trade is rather basic, the specificity and robust approach with which the ECT deals with the matters relating to energy trade, investment, and transit via fixed infrastructure is more telling. This section highlights

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[220] Article 4 of the ECT.
[221] See Preamble to the ECT, Article 9 (1), 10 (1, 3, 7).
[222] Article 7 (1) and 10 (5) (b) respectively
[223] Annex 2, item 3 (1) and (3)
[224] Both in the ECT Article 26 and in the G-Directive specific to gas disputes in Article 34 (3) and (4)
[225] Coop Graham, '*The Energy Charter Treaty: What Lies Ahead?' in* Coop, G., and Ribeiro, C., (eds) '*Investment Protection and the Energy Charter Treaty*' (JurisNet, LLC, Arbitration Institute of the Stockholm Chamber of Commerce, 2008) at 320

those areas that raises the question of possible 'normative conflicts' arising from the ECT's provisions that are regarded as improvements upon the GATT provisions as it relates to trade and trade-related investment measures. This engenders the question of which of them is most competent to govern trade in energy products (oil and gas).

2.5.2.1 Freedom of Transit: Article V GATT and Article 7 ECT

These two provisions embody the transit regime valuable for a discussion on competence in the international regulation of oil and gas transit via the territory of a transit country. The territory of a transit state is a crucial subject under international economic law relating to trade in goods as instituted by the Barcelona Convention on the Freedom of Transit and Statute of Freedom of Transit of April 1921, which requires that such transit is only a portion of a complete journey, beginning and terminating beyond the transit state's frontier.[226] Pipeline transit through a transit state will only be economical if the obligations of transit states spelt under international law are enforceable.[227] In reiterating the importance of transit states, Conventions that deal with transit was referred to as "part of a wider concept of 'freedom of transit' in public international law".[228] **Article V of the GATT** covers 'traffic in transit'[229] to include passage of goods and means of transport (except aircraft not carrying commercial

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[226] Article. 1

[227]Azaria, D., *Treaties on Transit of Energy via Pipelines and Countermeasures* (Oxford University Press, Oxford, UK) 2015 at 59-62

[228] E Lauterpacht , 'Freedom of Transit in International Law', in *The Grotius Society Transactions for the years 1958 & 1959, Problems of Public and Private International Law* (London: Longmans, Green, 1945–1959).

[229] Para. 1

goods)[230], freedom of transit through territories of Member countries,[231] charges for transit,[232] and the 'no less favourable treatment' principle and maintenance of terms of direct consignment to destination country already existing at the date of the GATT Agreement.[233]

Article 7 of the ECT similarly regulates freedom of energy transit, non-discrimination as to origin, destination, and origin (the Most Favoured Nation provision);[234] enabling the co-operation of energy entities to facilitate transport facilities;[235] no less favourable treatment for energy originating from or destined for transit country;[236] no disruption of flow of energy;[237] obligation not to obstruct the establishment of new capacity;[238] dispute resolution;[239] and negotiations on transit protocol involving any Member State.[240]

What is obvious from this comparison is that although Article 7 ECT (paras 1-8) extends to energy carriage via mobile means and through waterways, Article 7 firmly stands out in addressing the 'fixed infrastructure' (i.e., energy pipelines and grids) aspect of energy trade. In discussing energy transit, this research does not concern itself with other means of transit, except fixed infrastructure. Unlike Article V:1 GATT, Article 7 ECT captures

[230] Paragraph 1 and the last sentence of paragraph 2 were based on the text of the Barcelona Convention and Statute on Freedom of Transit of 20 April 1921. Notes to the New York Draft Charter Article 16 (which corresponds to Article V) state that there is no apparent inconsistency between that Article and the Barcelona Convention. EPCT/34/Rev.1, p. 12; EPCT/C.II/W.11; EPCT/C.II/PV.2, p. 63; EPCT/C.II/PV.10, p. 3. The Drafting Committee on Article 16 of the New York Draft Charter excludes transit of persons.
[231] Para. 2
[232] Paras 3, 4, and 5
[233] Para 6.
[234] Para. 1
[235] Para. 2
[236] Para. 3
[237] Para. 4
[238] Para. 5
[239] Paras. 6-7
[240] Para 8.

in intricate detail, peculiarities in energy transit that are not commonplace in other areas of transit. It particularly makes reference to "modernising Energy Transport Facilities" to ensure the "supply of Energy Materials and Products" (para 2), and "secure established flow of Energy Materials and Products…" (para 5). Article V:1 GATT on the other hand gives a rather generic description of 'freedom of transit' and does not go any further to define 'traffic in transit' to include energy pipelines even though transit pipelines predate the GATT of 1994. Art. V:1 provides thus:

> *"Goods (including baggage), and also vessels and other means of transport, shall be deemed to be in transit across the territory of a contracting party when the passage across such territory, with or without trans-shipment, warehousing, breaking bulk, or change in the mode of transport, is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across whose territory the traffic passes. Traffic of this nature is termed in this article "traffic in transit".*

This important distinction accords the ECT more specificity in regulating energy transit and as such, qualifies as the more detailed regime on trade in energy via pipelines in comparison with the GATT.[241] It may seem that Article V:2 GATT projects Article V as an omnibus provision such that the presumption of transit in energy can be inferred. **Article V:2** provides thus:

> *"There shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties. No distinction shall be made which is based on the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, of vessels or of other means of transport".*

But such presumption has not been tested in the WTO DSB. In fact, the only energy transit dispute ever brought before the WTO was a case relating to road oil transit

[241] Article 7(10)(b) of the ECT refers to 'Energy Transport Facilities' to include high pressure gas transmission pipelines, high-voltage electricity transmission grids and lines, crude oil transmission pipelines, coal slurry pipelines, oil product pipelines and other fixed facilities specifically for handling Energy Materials and Products.

between Slovenia and Croatia. That said the WTO DSB has been faced with interpreting the purport of Article V in the *Colombia-Ports of Entry* case[242], and the outcome of the case is instructive for an interpretation of its application to energy transit. In giving credence to a generic interpretation of Article V:1 the Panel held thus:

> *"the definition of "traffic in transit" provided in Article V:1 seems sufficiently clear on its face. When applied to Article V:2, "freedom of transit" must thus be extended to all traffic in transit when the goods' passage across the territory of a Member is a only a portion of a complete journey beginning and terminating beyond the frontier of the Member across whose territory the traffic passes. Freedom of transit must additionally be guaranteed with or without trans-shipment, warehousing, breaking bulk, or change in the mode of transport".*[243]

Further, in examining the purport of Article V:2, the Panel explored provision through the construct of the first and second sentences. It observed that in the first sentence- "*There shall be freedom of transit through the territory of each contracting party …*" and ... "*via the routes most convenient for international transit ...*" introduced the obligation to allow freedom of transit subject to the convenience of the route. i.e., A Member is not required to guarantee transport on necessarily any or all routes in its territory, but only on the ones "most convenient" for transport through its territory.[244] On the other hand, the Panel category stated that amongst others, Members are prohibited from making distinction based on, amongst other, *treatment of goods, or based on the transport or vessel of the goods.*[245]

If anything, the interpretation of Article V:2 of the GATT should settle the issue of whether Article V covers energy in transit. The down side of such generic ancillary

[242] *Colombia – Indicative Prices and Restrictions on Ports of Entry* WT/DS366/R, 27 April, 2009
[243] Panel Report, Para 7.396
[244] Panel Report, Paras 7.399-7.401
[245] Panel Report, Para 7.402

application is that it would not specifically address that details of fixed infrastructure, and again, this is where the ECT Article 7 proves more effective.

This limitation of Article V of the GATT led to the proposal on energy transit in the *Doha Round of negotiations on Trade Facilitation*.[246] In the course of the negotiations, some WTO Members noted that this lack of specificity and lack of detail in Article V meant that such terms of transit facilitation have to be determined on a bilateral basis, thereby hinting at not just a clear weakness of the GATT in this area of trade, but also an acknowledgment of the strength of the ECT on whose platform some bilateral energy transit agreements are entered.[247] And assuming 'pipelines and grid' were clearly defined in Article V GATT, it would still fall short of all the energy transport facilities covered by Article 7 ECT. Hence, this clarity in Article 7 ECT on energy transit via fixed infrastructure would prove more convenient for disputing parties who are both WTO and ECT Member states.

2.5.2.2 Trade-Related Investment Measures: Article III:4 GATT and Article 5 (3) ECT

Generally, Paragraphs 1 and 2 of the Annex to the TRIMS Agreement read in conjunction with Article III:4 GATT is essentially the same and almost similarly worded as Article 5 (1) and (2) ECT. In fact, Article 5 (1) makes reference to Article III or XI:1 of the GATT just as paragraphs 1 and 2 of the TRIMS Agreement makes reference to Articles III and

[246] The WTO Singapore Ministerial Conference in December 1996 directed the Goods Council 'to undertake exploratory and analytical work … on the simplification of trade procedures in order to assess the scope for WTO rules in [the area of trade facilitation]'. The mandate of the Goods Council was defined in Annex D of the Doha Work Programme Decision to include the clarification and improvement of several aspects of GATT Articles V, VIII and X.

[247] For instance, Turkey and Georgia – Proposal on a Free and Transparent Transit Regime in Road Transportation – Revision, Negotiating Group on Trade Facilitation, TN/TF/W/146/Rev.1, 10 March 2008, 1.

XI:1 of the GATT. Looking more closely however, Article 5 (3) ECT points to an area of possible conflict with the GATT provisions as will be seen ahead.

2.5.2.3 Border Measures: Article XI:1 GATT and Article 3 ECT

The ECT affirms that its provisions on trade were initially based on the trading regime of the GATT and so its trade provisions are in line with WTO rules and practice.[248] However, the Trade Amendment to the Treaty of 1998 expanded the scope of the treaty on trade "to cover trade in energy-related equipment, and sets out a mechanism for introducing in future a legally-binding stand-still on customs duties and charges for energy-related imports and exports."[249] Its specificity of trade in energy was generically captured in Article 3. **Article 3 of the ECT** provides thus:

> *"The Contracting Parties shall work to promote access to international markets on commercial terms, and generally to develop an open and competitive market, for Energy Materials and Products."*

While Article 3 is not as explicit as Article XI:1 of the GATT, both provisions embody each treaty's competence in governing border measures. One thing is obvious from their language though. While Article XI:1 of the GATT is a command obligation, Article 3 of the ECT does not exude command. To recall, the relevant part of Article XI:1 states that "*No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party*" (emphasis mine)

[248] See Trade Section of the Introduction to the ECT.
[249] *Ibid*

3.5.3 *Binding force*

Although Article 3 of the ECT, as seen above, does not have a 'command' language as does Article XI of the GATT, Articles 26 (8); 27 (3) (h), and 40 (1) ECT are clear on the binding character of the arbitral tribunal findings following a dispute resolution under the auspices of the ECT. Intrinsically, the ECT affirms that – by accession, states agree to the ECT's characteristics as "legally binding" on them.[250] Therefore, whichever dispute settlement regime states choose, they become bound by the outcome. In essence, a party that is unsatisfied with the decision of the WTO DSB where it relates to any of the matters set out in both the GATT and the ECT cannot later seek redress in the ECT arbitral tribunal and vice versa. This does not show a conflict in the area of dispute resolution.

3.5.4 *Consequence following breach*

Flowing from the discussion on binding character, there is no discernible conflict over the consequences of breach.

3.5.5 *Areas of conflict with the WTO*

Commendably, the ECT consolidates and even improves upon the GATT. This is conventional view. While this research holds this view, it sidesteps a little bit to suggest that, in spite of their complementary relationship, there are possible areas of conflict. Article 5 (1) & (2) of the ECT is strikingly similar to Paragraph 2 of the TRIMS Agreement. Article 5 (1) particularly provides thus:

"A Contracting Party shall not apply any trade-related investment measure that is inconsistent with the provisions of article III or XI of the GATT; this shall be without prejudice to the

[250] See Introduction to the ECT and the Preamble of the ECT.

Contracting Party's rights and obligations under the GATT and Related Instruments and Article 29"

But Article 5(3) then goes to provide thus:

"*Nothing in paragraph (1) shall be construed to prevent a Contracting Party from applying the trade-related investment measures described in subparagraphs (2)(a) and (c)* [similar to para 1 (a) and (b) of the Illustrative List of the TRIMS Agreement] *as a condition of eligibility for export promotion, foreign aid, government procurement or preferential tariff or quota programmes".*

Article 5 (4) then provides:

"Notwithstanding paragraph (1), a Contracting Party may temporarily continue to maintain trade-related investment measures which were in effect more than 180 days before its signature of this Treaty, subject to the notification and phase-out provisions set out in Annex TRIM"

Going by Article 5(3), ECT member states may derogate from the obligations under the TRIMS Agreement and Article XI and III of the GATT where the implementation of trade-related investment measures which are in the character of local content requirements and trade balancing requirements is a condition for their eligibility for export promotion, foreign aid, government procurement or preferential tariff or quota programmes. This is re-echoed in Article 45 ECT whereby signatories can provisionally apply the ECT as long as such application is not inconsistent with their domestic law, and as long as they do not exercise their opt-out option under Article 45 (2) (a) ECT.[251] However, in the event of disputes relating to TRIMs, Australia objected to dispute settlement bodies under the Charter giving interpretations on Article III and XI GATT

[251] For a richer discussion on Article 45 of the ECT, see Leal-Arcas R., *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance* (Edward Elgar, Cheltenham, 2011) at 150-151.

where the dispute involves ECT members who are also GATT member states. To them, the WTO dispute settlement body should be the forum for their dispute settlement.[252]

3.6 <u>**The UNGA Resolution 1803 (XVII) of 1962 Vs The WTO Agreement**</u>

The common discrepancy between the PSNR principle and the *pacta sunt servanda* principle of international law is in the context of party breach of BITs, which necessitates investment treaty arbitration under ICSID.[253] It has even been recently argued that bilateral contracts can serve both states and investors without the need for BITs while still ensuring states' adherence to concessions in the form of 'promise' made in the contract through the enforcements of ICSID.[254] However, in the context of multilateral treaty and the PSNR principle, the Appellate Body gave a very unequivocal summation on the influence the WTO has over state sovereignty when it held thus: *"It is self-evident that in an exercise of their sovereignty, and in the pursuit of their own respective national interests, the Members of the WTO have made a bargain. In exchange for the benefits they expect to derive as Members of the WTO, they have agreed to exercise their sovereignty according to the commitments they have made in the WTO Agreement.*[255] This finding has gained scholarly support on the foundation that consenting to the WTO is consenting to a "higher

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[252] Observed in the Final Act of the European Energy Charter Conference, held at Lisbon, 16-17 December 1994. O.J. (1994) L 380/3 ILM; and see the scope of the 'opt out' clause of Article 5(3) ECT in MacDougall & Cameron, '*Trade in Energy and Natural Resources*' 28.3 JWT (1994), p. 178

[253] Jason Webb Yackee , '*Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality*', Fordham International Law Journal Volume 32, Issue 5 2008 Article 5, pp 1550-1613; Sornarajah, M., *The International Law on Foreign Investment* (2004) pp 259-68; Vicki Been & Joel C. Beauvais, '*The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*', 78 N.Y.U. L. REV. 30, 129 (2003) (addressing the North American Free Trade Agreement specifically); Gus VAN HARTEN, Investment Treaty Arbitration and Public Law 167-75 (2007);

[254] Jason Webb Yackee, *ibid*

[255] AB, *Japan- Taxes on Alcoholic Beverage,* WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R, 4th October, 1996, at para. 16.

norm".[256] This undermines the notion of absolute sovereignty and recognises the diminishing of it. The credibility of this quote notwithstanding, it does not seem to pay attention to the realities of trade protectionism when it comes to natural resources.

The Panel in *China-Raw Material* case noted that a WTO Member State has "inherent and sovereign right to regulate trade..." – albeit already exercised by its capacity to engage in negotiating the terms of its accession into the WTO.[257] When it comes to natural resources, it would seem though that producing states have *not* agreed to exercise their sovereignty in accordance with commitments of reciprocity they have made in the WTO Agreement (or while negotiating their accession).

States' sovereignty over natural resources are not 'absolute'. Rather, they are regarded as 'permanent'. Permanence here does not imply a regime without limits. The U.N. General Assembly Resolution 3281 (XXIX) of 1974 titled 'The Charter of Economic Rights and Duties of States'[258], which heavily reaffirms the permanent sovereignty principle, places some limitation on states' exercise of this right such that states are prohibited from causing interference with other States' territory as a result of exercising their PSNR rights within their territory.[259] This is how far the limitation on this right goes. Provided other adjoining states are not negatively affected by a state exercising its right over natural resources, there is no limit to how a state deems fit to regulate natural resources within

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[256] John H., Jackson, 'Sovereignty, the WTO And Changing Fundamentals of International Law', 2006, p. 698 on state consent, the author stated that, '*if…each "sovereign" is supreme in the international system, then…no higher norm can legitimately apply to that sovereign unless it has consented."*

[257] See Para.7.156-157

[258] GA Res. 3281(xxix), UN GAOR, 29th Sess., Supp. No. 31 (1974)

[259] Article 3 requires States engaged in the exploitation of natural resources shared by two or more countries, to co-operate on the basis of a system of information and prior consultations in order to achieve optimum use of such resources without causing damage to the legitimate interest of others.

its territorial boundaries. This is not normally a concern for the WTO, provided states by exercising their sovereign do not violate their WTO obligations. And where states have common interests, domestic regulation are exercised through international cooperation amongst those countries. As seen above, both OPEC and the ECT as treaty associations have their foundation in the PSNR principle of international law.

The ECT explicitly re-echoes the PSNR principle in Article 18 ECT thus, "*The Contracting Parties recognize state sovereignty and sovereign rights over energy resources. They reaffirm that these must be exercised in accordance with and subject to the rules of international law*"[260] and in giving credence to their exercise of this right as they deem fit, it states also that *"Each State continues to hold in particular the rights to decide the geographical areas within its Area to be made available for exploration and development of its energy resources, the optimization of their recovery and the rate at which they may be depleted or otherwise exploited…"*[261]. OPEC affirms this- albeit implicitly, in Article 2 OPEC Statute. This explains why even though they are both international treaties, they reaffirm their Member States' regulatory autonomy.[262] Having examined the relationship of normative conflicts/differences between the WTO and OPEC and the ECT, it is imperative to examine the implications or otherwise of the UN Resolution 1803 of 1962 on PSNR on the competence of the WTO in governing these resources.

The principle of permanent sovereignty over natural resources was originally articulated by colonized countries during the colonial era due to the inequitable economic regime

[260] Article 18 (1)
[261] Article 18 (3)
[262] Articles 2 (a), (c) and 3 OPEC Statute; Article 18 ECT

witnessed in their countries by foreign companies, and which that perceived as taking advantage of their vulnerable governments. Hence, the principle was articulated to facilitate the nationalization of foreign enterprises engaged in the exploitation of natural resources within their territories and to resolve the question of compensation.

The argument was an economic and political one, and that sovereignty over natural resources is an essential prerequisite for economic independence and development and therefore a cardinal component of state sovereignty. As a result, developing countries extended the principle of non-intervention to the economic field by claiming the right to possess and freely dispose of their natural resources. And one major ideology that marked the PSNR is that it was set against the freedom of treaty and the principle *pacta sunt servanda* ("agreements are to be kept").[263] This meant that the PSNR principle is, as Franz Xaver Perrez puts it, "opposed to the structures of economic domination of the present international system".[264]

Sovereignty has even been regarded as the exception to the *pacta sunt servanda* principle in international trade terms, [265] while fragmentation of treaties is also seen as a limitation on the *pacta sunt servanda* principle.[266] By this, it challenges any absoluteness of WTO obligations which states must adhere to, especially if they encroach on their sovereign

[263] In the context of international treaties, this principle is re-echoed by Article 26 of the Vienna Convention on the Law of Treaties, 1969. It provides that: "*every treaty in force is binding upon the parties to it and must be performed by them in good faith.*"
[264] See Franz Xaver Perrez, '*The Relationship between "Permanent Sovereignty" and the obligation not to cause Transboundary Environmental Damage*" Environmental Law, (1996), vol. 26, pp 1190-1211
[265] Booysen Hercules, *Principles of International Trade Law as a Monistic System* (South Africa, Interlegal, 2007)
[266] Christina Binder, '*Stability and Change in Times of Fragmentation: The Limits of Pacta Sunt Servanda Revisited*' Leiden Journal of International Law Vol. 25, Issue 4, December 2012.

rights over natural resources, particularly Articles III:4, XI:1, and paragraphs 1 and 2 annex of the TRIMS Agreement directly relevant to natural resources as earlier noted.

This background is central to examining the competence of the WTO *vis-à-vis* the normative construct of the PSNR. In spite of the revolutionary background of The Resolution, it was carefully written to encompass the principles of international law on good faith, development, and compensation in the event of nationalization. It also affirms the rule of *pacta sunt servanda* by recognising the binding effect of investment agreements between States and investors, thereby gaining the unanimous accent of the committee of nations.[267]

This notwithstanding, although The Resolution recognises States' sovereign control over natural resources, such sovereign control does not encompass international trade in natural resources. Also, unlike BITs the WTO is an institution with its own Dispute Settlement Body whose decisions are given binding effect on Member States that committed to its binding obligations as a prerequisite to their accession. Since the WTO Agreements can be classed as treaty contracts, the *pacta sunt servanda* principle comes the fore vis-à-vis the PSNR principle. Against this backdrop, conflicts between resource producing states' commitments to the WTO rules on National Treatment and Quantitative restrictions as an inclusive obligation to all Member States and states' PSNR with exclusive management right becomes inevitable.

[267] Gess Karol, N., 'Permanent Sovereignty over Natural Resources: An Analytic Review of the United Nations Declaration and its Genesis', 13 *INT'L & COMP. L.Q.* 398 (1964)

This is especially the case when, beyond the Resolution XVII of 1962, we also consider the **Charter of Economic Rights and Duties of States** (CERDS) and its more emphatic reaffirmation of the weight of the PSNR principle than the Resolution XVII of 1962.[268] But just like with OPEC and the ECT, the first step is to present those key provisions in The Resolution that are in possible conflict with the WTO provisions, after which it becomes imperative to determine the weight of each systems to arrive at a possible hierarchy, which may in turn, give insight into whether the WTO equals, supersedes, or trails the competence of The Resolution.

3.6.1 Areas of possible normative conflicts with the WTO Specific Provision

Paragraph 1 of The Resolution provides thus: "*The rights of peoples and nations to permanent sovereignty over their natural resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned*". Paragraph 1 is not problematic or controversial in terms of the economic advancement it promotes but it embodies an atmosphere of self-determination which the WTO has through rigorous Rounds of negotiation worked so hard to get states to compromise. This provision essentially recognizes the '*rights*' of states, whereas the language of the WTO/GATT is constructed around the imposition of '*obligations*' on states with the aim of prohibiting trade restrictive measures. This does not in any way suggest the WTO undermines states' rights. This stark difference in language presents an ideological divide between states' *rights* versus states' *obligations*. And it puts a spotlight on states' restrictive measures riding on the back of their *rights* inherent in The Resolution arguably in

[268] G.A. Res. 3281 (XXIX), U.N. A/RES/29/3281 (Dec. 12, 1974) [hereinafter CERDS]

violation of their WTO obligation. I designate this conflict in 'obligation' versus 'right' a *conflict in applicable law*, rather than an inherent normative conflict.[269]

Paragraph 2: "*the exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, **restriction or prohibition** of such activities*".

The implication of Para 2 is that states can freely implement measures in the exercise of this right pursuant to national laws for whatever reasons the countries deem to be in their national interest (even though those measures may not be within the exceptions prescribed by GATT Articles XX (g), XI:2 (a), and XIII). This text effectively gives States' inherent right *to impose restrictions or prohibitions* (i.e., restrictive measures). In fact, the two main features of internal sovereignty have been identified to be: a state's range of competence within its borders and the exclusivity with which the state can exercise them - such competences essentially categorised by (a) the state's regulatory and economic functions; (b) its authority over natural and legal persons; and (c) its authority over natural resources and economic activity.[270]

In putting the third category in closer context, Strauss observed that equipped with such authority, an important element of the PSNR principle within a sovereign territory is the right to manage such resources as a producing State deems fit; which may include an

[269] See chapter 2.
[270] Nguyen Quoc Dinh, *et al., Droit international public, 7 ed.,* Paris, Librairie Generale de Droit et de Jurisprudence, 2002. P.474 cited in Strauss, M.J., *The Viability of Territorial Leases in resolving International Sovereignty Disputes* (Paris, L'Harmattan, 2010) p. 32-33.

authority to "*allow other states and their nationals to engage in activities on its territory*" and to also "*prohibit other states and their nationals from engaging in such activities*".[271] These features mirrors a major element of the PSNR which is, for all intent and purpose, the Local Content Requirement. However, being that such activities portray international relations between states, he believes that the international relations character of such interactions and the international norms emanating from them does ironically generate limits on sovereignty.[272] Twelve years after the Resolution 1803, the UN reaffirmed the PSNR in unequivocal language in its adoption of **CERDS**.[273] The relevant part provides:

> *Each State has the right…to nationalize, expropriate, or transfer ownership of foreign property, in which case appropriate compensation should be paid…taking into account…all circumstances that the State considers pertinent.*

In comparison though, while Resolution XVII of 1962 provides that States *shall* pay compensation in accordance with international law; connoting an obligation, CERDS of 1974 uses the word "*should*", connoting a recommendation. This seems a weaker language on the path of CERDS. More so, the payment of compensation may be made if the state considers it appropriate to do so. Summarily, under the CERDS, payment of compensation becomes the discretion of the state. This subsequent reaffirmation of resource-rich developing countries right became undermined by the popularity of BITs in the 1990s which gave guarantees to investors on the protection of their investment through the provision of 'adequate compensation' in the event of nationalization. And even though this development softened the language of the CERDS, it was likewise

[271] Strauss, M.J., *ibid*
[272] For a comprehensive analysis of the various competences of states between their internal sovereignty and external sovereignty, see Strauss, M.J., *ibid* Chapter 1.
[273] *Supra* note 264

endorsed by many developing countries looking to attract more foreign investors at a time when they did not have the technological know-how to invest in energy production.[274] That has changed today, as we can see from the wind of local content requirement blowing across developing producing states.

3.6.2 *Legal Form of the UN Resolution 1803 (XVII) of 1962 in international law*

The United Nations in recognising the inherent right of states to manage their natural resources without any external intervention formulated and developed four resolutions towards that goal. Three of them were developed in the 1950s and which conferred 'inherent right on states to dispose of its wealth and their natural resources'[275], inherent right 'to determine freely the use of their resources'[276] and that this right 'is inherent in their sovereignty.'[277] These resolutions paved the way for the landmark 1962 Resolution on Permanent Sovereignty over Natural Resources.[278] The status of UN Resolutions in international law and by extension, the Resolution 1803 on PSNR becomes relevant when considering relationship of conflict between The Resolution and the relevant WTO rules applicable to natural resources as well as national laws. The competence and powers (*or legal significance*) of the United Nations General Assembly (and Security Council), especially in respect of domestic matters has been adjudged to be the most prevailing

[274] Guzman Andrew, T., 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' *38 VA Journal of International Law. 639* (1998)
[275] UNGA Resolution 'Concerted action for economic development of economically less developed countries', 15 December 1950, UN Doc. A/RES/1515(XV) (Resolution 1515)
[276] UNGA Resolution 'Integrated economic development and commercial agreements', 12 January 1952, UN Doc. A/RES/523(VI)
[277] UNGA Resolution Right to exploit freely natural wealth and resources, 21 December 1952, UN Doc. A/RES/626(VII) (Resolution 626), at 18
[278] Resolution 1803 (XVII), 17 U.N. GAOR Supp. (No.17) at 15, U.N. Doc. A/5217 (1962). Hereinafter 'The Resolution'.

controversies on the explicit adjudicative character of the UN Charter provisions.[279] A preliminary discussion on the relationship between the WTO and The Resolution as relevant to natural resources is a pathway to understanding which category of international law Resolutions of the UNGA actually falls under. This will allow for a proper analysis of whether the WTO's relationship with The Resolution is more of a Treaty versus International Customary Law, or a Treaty versus General Principles of Law. This will also help to determine the normative weight The Resolution carries vis-à-vis the WTO for the purpose of hierarchy. Recall that for the sake of precedence, treaties and customs are equal, while treaties take precedence over general principles of international law (i.e., general law)

3.6.2.1 UNGA Res XVII on PSNR as Customary International Law

There are debates and literatures as to whether GA Resolutions generally fall under customs or general principle of international law.[280] The importance of these debates goes to the issue of whether The Resolution 1803 will be given binding effect. While some are of the position that 'general principles' are to be read narrowly since they are an

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[279] Schachter, O., 'The UN legal order: an overview' *in,* Joyner C., (ed.) *The United Nations and International Law* (England, Cambridge University Press, 1997) at p.9

[280] See generally, Villiger, E.Mark, *Customary International Law and Treaties: A manual on the theory and practice of the interrelation of sources* (Kluwer, 1997); Klabbers, J., *The concept of Treaty in International Law* (Mertinus Nijhoff, Netherlands, 2006); *Nicaragua* case at para 188 and 191 where the ICJ fut GA resolutions in the mould of customary international law as *Opinio Juris.* Szasz, P., *General Law Making Process, in* Schachter, O., and Joyner, C.C., (eds) *United Nations Legal Order*, *ASIL (1995)* at 440. The author highlighted the role of State practice over a long period of time as a catalyst for the development of international law in a given area by noting that "*State practice becomes a major factor in determining whether GA resolutions will give rise to new norms of international law, or merely remain recommendations for action*" and that concerning the Resolution 1803, because its norms have gained recognition through repetition and "sponsorship" by the international community, they crystallize into principles of international law adopted by the GA and ratified by requisite number of parties

independent source of law that are separate from custom,[281]and others consider GA Resolutions as coming under 'general principles of international law' with the permanent sovereignty over natural resources being a fundamental (general) principle of international law[282], others take the position that 'general principles' category are almost redundant in the light of custom, and that they are just norms consolidated out of customary practice.[283] Customs are binding while general principles of international law are not. In general, Customary International Law is a primary source of law that comes to be through the practice of nations in a particular area. General Principles of International Law on the other hand is that source of law which international law resorts to when primary sources such as treaties, statutes, and customs do not provide guiding authority for the benefit of parties in a relationship of dispute to determine the dispute.[284] As such, general principles of law may be used to fill a void or "gap" left by the silence of customary international law and treaties. General principles of law may be referred to as "non-consensual" sources of international law, which perfectly describes Resolution XVII of 1962 which applies to a state just by attaining statehood, compared to the WTO which is by accession.

3.6.2.2 Is the GA Res. on PSNR a jus cogens to weigh heavily against a Treaty?

While noting that the GA has also been credited as sources of notable agreements on Human Rights such as the UDHR, ICCPR, and the ICESCR, he also singles out the

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281 Virally, *The sources of International Law, in* Manual of Public International Law 143-148 (Sorensen, M., ed 1968). See also, RESTATEMENT (Revised) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES. 102(4) (Tent. Draft No. 1., 1980).

282 Hossain, K., and Chowdhury, S.R., *Permanent Sovereignty Over Natural Resources in International Law: Principle and Practice* (Frances Pinter; London, 1984)

283 Joyner., 'U.N. General Assembly Resolutions and International Law: Rethinking the Contemporary Dynamics of Norms-Creation', *11 CAL. W. INT'L L.J.* 445, 459-460 (1981)

284 See International Judicial Monitor. http://www.judicialmonitor.org/archive_0707/generalprinciples.html (Last visited January 14, 2014)

Resolution 1803 on PSNR, criminalization of apartheid,…etc., as "resolutions used by developing nations as vehicles to propagate new concepts to the international community." Brigitte Bollecker-Stern makes a very instructive distinction between legally forceful resolutions and non-legally forceful ones such as the Charter of Algiers.[285] In singling out the Resolution 1803 on PSNR and its legal significance as a special type of resolution, he appraises a Resolution's legal and normative force in terms of (a) *The representation of their adoption;*[286] (b) *The precision of their content;*[287] and (c) *Means of enforcement.*[288] While the first two are clear cut for the PSNR resolution, its means of enforcement is inherently problematic.

Nowhere in the texts does it mention that the United Nations reserves the right to enforce the rights therein in the event that the rights of the peoples are violated. Neither does it anywhere require states to enforce those rights. Rather, the preamble desires that there should be further consideration by the United Nations of the subjects of permanent sovereignty over natural resources in the spirit of international co-operation in the field of economic development, particularly that of the developing countries. This may suggest that the PSNR does not have an enforceable legal effect. But points (a) and (b) above appears to neutralise that assumption. To further support its normative force, the

[285] For instance, the Charter of Algiers which was adopted by the non-aligned in 1973, as well as the United Nations Charter of Economic Rights and Duties which was though adopted by a very large majority, did not receive the consent of the industrialized States.

[286] The larger the majority of international community adopting a resolution, the more likely it will have a law-making character with a binding force. e.g., is the case where it is adopted by a majority representing all groups in the United Nations such as the Resolution 1803 on Permanent Sovereignty over Natural Resources which focuses on and is adopted by all groups representing the international community- both the developing States and the developed States alike

[287] The more the clarity of aims and objectives of the resolution, the more likely they have legal consequences. The Resolution 1803 is taken to be a precise instrument as it clearly sets out its aims and objectives and prescribes eight obligatory declarations that embody the objectives in details.

[288] Where the UN is the one that takes action to enforce the Resolution, then it has more binding effect, but where it requires the States to take action to enforce the provisions of the Resolution, then it's more complicated.

PSNR has been arrogated the status of being a part of *jus cogens* in the light of Article 53 of the Vienna Convention of the Law of Treaties of 1969 which interprets *jus cogens* as obligations that cannot be derogated from. States cannot in principle derogate from their obligation or give up their rights under the PSNR Resolution.[289] Other prominent scholars have tolled this line of the UN Resolution 1803 being *jus cogens*.[290]

This would by implication mean that as *jus cogens* is the only exception whereby a general principle of law would prevail over a treaty, PSNR rights recognised in Resolution 1803 would prevail over obligations in the WTO. But there's a problem. Whereas a violation of *jus cogens* would normally attract international sanctions, states' deviation from the *good faith* principle in The Resolution does not attract international sanction other than bad press. It is hard to see how the PSNR qualifies as *jus cogens* in this respect. Even a foreign states' violation of a sovereign states' PSNR through environmental damage and un-contracted exploration will hardly attract international sanction with the same measure as genocide would for instance. For this reason, I acknowledge the political and sacredness of the PSNR principle, but do not recognise it as having status of *jus cogens*. This position frees up the issue for further debate on the *lex specialis* and bindability of Resolution 1803 *vis-à-vis* the WTO regime.

[289] See Lowe J., *International Law* (Oxford University Press, 2007) at 59. The author equates the right of permanent sovereignty over natural resources to be as inalienable as human rights, and that even States are obligated to not deny its citizens the benefit of the right to those natural resources. A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character

[290]; Hazard John, '*Treaties', in* Cassese Anthonio and Weiler Joseph (eds), *Change and Stability in International Law-Making* (Berlin, Walter de Gruyter, 1988) at 8.

3.6.3 The Lex Specialis principle and the WTO/UN GA Resolution on PSNR conflict

In this circumstance, both norms apply to both natural resource-rich countries and net importing countries. More like the AB/AB conflict, it is much straightforward. Since a *lex specialis* prevails over a general law, by implication, this would suggest that in the event of conflict, the WTO rules would prevail since the UN GA Resolution on PSNR is not a treaty but a general law (or customary international law). But if we must put the term *lex specialis* in deeper context, using the criteria listed earlier in chapter two (i.e., it must be a written rule; an explicit expression of intent of the highest level of government; must be focused on a specific field) and giving these criteria a broad definition, The Resolution appears to meet these criteria. It would be *lex specialis* when compared with another law that is *lex generalis*. But if these criteria are given a literal definition, we can say it doesn't qualify as a *lex specialis* because the criteria refer to specific agreements entered into by sovereign governments, and not a supranational entity as the United Nations. In that regards, it would not be a *lex specialis* under any circumstance, even if it relates to the field of natural resources specifically. More so, natural resources are a generic description of the various types of resources, and so it is not a specific field within the meaning of the GA Resolution. The second scenario is more sensible. While The Resolution may be arguably a *jus cogens,* it is not particularly a *lex specialis.* It does not need to be a *lex specialis* to be potent if it is indeed a customary international law.

3.6.4 Binding force

Generally, though it has been established above that there is a presumption of the non-binding nature of the UN Resolutions generally, this presumption is a rebuttable presumption.[291] For instance, the Resolution on Permanent Sovereignty over Natural Resources, *requires* states in paragraph 4 to make payment of appropriate compensation upon nationalization, expropriation or requisitioning. A few others have had binding effect.[292] The debate as to what is 'appropriate' compensation is an important debate but not relevant to this research. What is relevant here is that such payment of compensation is a requirement which states are obligated (*or compelled*) to fulfil. This situation is where the Resolution has a binding force and not those requiring states to use the resources in the interest of their national development and of the well-being of the people of the state concerned.[293] This latter requirement is at best a requirement of good governance rather than legal requirement. These notwithstanding, the presumption of non-binding effect of the G.A resolution on PSNR in its holistic form can still have academic relevance.

3.6.5 Sphere of Influence

Although the UN is a globally inclusive institution, the UN through the instrumentality of UNCTAD[294] and the GA Res on PSNR serves to protect the interest of individual producing states. Hence, for the purpose of this research, the UN General Assembly Resolution on PSNR is categorised as an instrument that promotes an exclusive, rather

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291 See Mendelson, M., 'Legal Character of General Assembly Resolutions: Some Considerations of Principle', *in Legal Aspects of the New International Economic Order* (Hossain, K., ed., 1980)

292 E.g., The 'housekeeping resolutions' admits members and regulates internal issues like apportioning of the budget; any decision taken to 'interpret' the UN Charter; Resolutions that dispose of territory such as the resolution terminating the mandate over Namibia.

293 Paragraph 1.

294 UNCTAD Final Act and Report, U.N. Doc. E/Conf. 46/161, Vol.1 at 63 Annex A. VI. 2. (1964) – which **recognizes** the trade needs of developing countries in non-renewable natural products as their main export, **considers** 'the need for those countries to reach speedily a certain stage of economic development from the export of these products, and **recommends** 'that international organizations set up by the principal exporting developing countries to enable them defend their interest, be recognised. See also, Para 2 of the UN Resolution on Permanent Sovereignty over Natural Resources *Supra* n 31.

than inclusive, competence to manage natural resources.[295] Although the UN also promotes extraterritoriality, that is in instances when a resource lies between two states and is shared by those two states.[296] The Resolution 1803 being specific to natural resources has global appeal as an economic instrument to the extent that its audience is the international community made up of all sovereign states. However, it simply recognises and seeks to protect the interest of sovereign states with natural resources and its peoples, and not the international community as a whole. For instance, The Resolution is of no economic or political significance to a small country without natural resources. While The Resolution does not regulate international trade in natural resources, it recognises and validates states' inherent rights to management of their natural resources to meet their economic and developmental goal. And where this right encroaches on trade areas, either directly or through trade effects of internal management, it invokes the coverage of the WTO since trade in natural resources for economic and developmental goal is also arguably within the scope and objective of the WTO.

3.6.6 Consequence following breach

Paragraph 1 requires that this right must be exercised in the interest of their national development and of the well-being of the people of the state concerned. **Paragraph 2** requires that the exercise of this right should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction or prohibition of such activities.

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[295] Arsanjani, M., *International Regulation of Internal Resources: A study of Law and Policy* (Virginia, University press of Virginia, 1981) at 390.
[296] See UNGA Resolution 3129 (XXVIII) of December 13, 1973.

The purposive effect of these prescriptions in terms of a violation is that it appears the violation envisaged by the UN is more of a violation against 'the peoples' of the nation state by their own governments such that management of resources is not channelled towards their development. However, nowhere does The Resolution prescribe a consequence for such breach. The emphasis therefore appears to be on the recognition of the right of states to the exclusion of other States interference rather than on the consequence in the event such states abuse this right.

3.7 **Conclusion**

What this chapter has shown is that determining the relationships between the WTO rules relevant to energy on one side, and energy-focused institutions or regimes on the other side is quite complex in terms of which is more competent to govern trade relations and investment decisions in energy. Tellingly, it is the only sector of the global economy that is multifaceted along institutional lines, with each institutions having some credible measure of competence based on their legal characters either as treaties (ECT and OPEC) or as customary international law (UN Resolution XVII of 1962), or as sovereign states exclusively. One thing that stands out is that this addresses the issue of 'competence' in natural resource governance from the perspective of *inclusive, partially inclusive,* and *purely exclusive* regimes.

The specificity with which the ECT deals with trade in oil and gas involving quota and trade-related investment measures affecting pipeline commodity and investment in pipeline capacity along the value-chain compared with the GATT's general approach to trade in goods gives weight to the ECT's competence over the WTO on issues relating to oil and gas via pipelines. There is however no inherent conflicts or conflicts in applicable law compared to the WTO's relationship with OPEC which is one of conflict in applicable law. Ideologically, though the WTO is not about redistribution of wealth but to – albeit arguably, engender the inclusion of poorer nations in international trade to foster their economic developments, an agenda which needed its designing a comprehensive legal framework in the GATT, OPEC on the other hand is not focused on engaging poorer nations but rather on an economic goal built on Member states' economic interest on oil, whilst also facilitating cooperation with consuming countries. Hence while WTO derives its competence from its legal construct, OPEC derives its competence from that relational interest much more than its legal form.

The sovereignty question that gives right to pure exclusive national regimes with TRIMs like local content requirements in the oil and gas sector also poses a challenge for the WTO rules on TRIMs. While the normative force of sovereignty in states' relations with each other cannot be denied, sovereignty need not be a stumbling block to international trade. Several literatures have discussed sovereignty not in its traditional form but in its transformative context in relation to states' treaty obligations such as the WTO.[297] But then, the peculiarities of the oil and gas sectors compared to other goods must be put in context, even by the WTO.

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[297] Sarooshi, D., *International Organizations and their exercise of Sovereign Powers* (Oxford, Oxford University Press, 2005) pp. 3-7. He gave a systematic interpretation of the limitations of sovereignty as 'a concept that is subject to contestations since its meaning and scope is generally unclear; such that its legitimacy and governments' authority, even though recognized, can still be legitimately contested by international organizations on which the state has conferred powers'. See also Jackson, J., *Sovereignty, the WTO and Changing Fundamentals of International Law* (Cambridge University Press, 2006) p. 71 where he strongly faults any attempt to define sovereignty in terms of '*nation-state's supreme absolute power and authority, unfettered by any higher law or rule, and only limited by consent*'. He reasoned that this will make sovereignty arbitrary, and that such *antiquated version of sovereignty* doesn't exist in today's world.

4

Quota Measures and Trade-Related Investment Measures in the Oil Sector and their Trade Effects question

4.1 <u>Introduction</u>

> *"International economic law deals only with those measures that have a negative effect on trade and/or investment. It follows that a given measure may be scrutinised with respect to several norms"*
>
> \- Albath Lars [298]

Previous chapters observed that border measures and TRIMs in the oil and gas sectors, in spite of their nationalistic character, lie within the rubric of public international law due to multipolar regulatory regimes governing them as well as their consequent global economic implications arising from states' interdependence on oil and gas. And that states implementation of these measures under the auspices of these multipolar regimes invokes the discussion on the negative effects on states' international obligations under the WTO, thereby justifying the application of international law principles on conflict of norms to the conflicts of regimes governing oil and gas regulation. By extension, this invoked a further scrutiny of the legal character of each resource-focused regime *vis-à-vis* the WTO as a referendum on each regime's regulatory competence to govern the oil and gas sector.

This chapter presents a detailed examination of the regulatory structures of those border measures and TRIMs specific to the oil sector, as well as ascertain their trade effects in other to determine their relevance to or implications for the WTO. In essence, this chapter on the one hand examines these measures in their forms as treaty-based

[298] Lars, A., *Trade and Energy: Investment in the Gas and Electricity Sectors* (Cameron May, London, 2004) at 64

regulation, national regulation through laws and requirements, and contractual regulation through terms and conditions within PSCs. On the other hand, it weighs their impact on energy markets[299] and ascertains whether such market impacts constitute states' violation of international obligation under the WTO law - thereby giving the WTO's Dispute Settlement Body co-competence in the same fashion as the investment arbitration dispute settlement mechanisms in investment disputes. These measures will be specifically analysed in detail in their category as follows:

Quota Measures

a. Production restrictions;
b. Export ban

Trade-related Investment Measures

a. Local content requirements with case law interpretations namely: *Canada – Renewable Energy* and *Indonesia-Automobile* cases.
b. 'Discriminatory' acreage allocation
c. Regulatory acts of NOCs and their attribution to states, using the doctrine of 'State attribution'.

4.2 **The 'Trade Effects' question**

Before analysing the propriety of the trade effects of these measures, it should be noted that in WTO terms, the mere fact that a measure simply has trade outcome is not particularly relevant. What is relevant is that the measure actually violates Article XI:1 of the GATT. In other words, the issues is whether the trade effect has implications for

[299] Energy market in this context comprises the three economic blocks with either economic, industrial, or developmental interests that are either positively or negatively affected by export and TRIMs regulation in the oil sector. For export-only developing countries (largely OPEC countries bonded by similar economic interests) their economic agenda focuses on revenue-raising, which inspire a rent-seeking policy. This reflects their oil export-dependent economies. For export/consuming developing countries categorised as 'emerging economies' (i.e., the BRIC countries having no ties to any economic institution as it the case of OPEC), their hybrid revenue-raising and industrialisation economic agenda inspire a mixture of rent-seeking/export restriction policies which is a reflection of their both export-dependent and consumption-dependent economies. As for net import developed countries (largely OECD countries), their industrialisation economic agenda inspire policies inclined to free trade principles which reflects their heavily import-dependent economies. In all, both security of supply, security of export revenue are always a concern both for net importing and net exporting countries respectively.

the WTO and not whether the measure has simply restricted export or import. This principle has its foundation in case law from the WTO dispute settlement body.[300] The Panel in *Colombia – Ports of Entry* was however more cautious in coming to this conclusion. It evaluated internal measures based on 'their design' and their 'potential to adversely effect on importation' and rather came to the conclusion that the test of whether the 'ports of entry measure' is a restriction on importation within the meaning of Article XI:1 should be based on "whether the measure has a limiting effect on importation by negatively affecting the competitive opportunities available to the products in question".[301]

The prominent position is that current Panels would focus on a measure *simpliciter* and its potential to distort trade (negative impact on trade), rather than any mere existing trade effect. The underlying point is that, although trade effect need not be proven in evidence where a measure is WTO-inconsistent outright, an evidence of trade effect adds

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[300] *India – Quantitative restrictions on Imports of Agricultural, Textile and Industrial Products*, Appellate Body report circulated 23 August 1999, adopted 22 September 1999, WT/DS90/AB/R. para 5.128. Also in *European Community Programme of Minimum Import Prices, Licenses and Surety Deposits for Certain Processed Fruits and Vegetable,* Panel Report, 18 October 1978, BISD 25S/68. para 4.9 (*EEC – Minimum Import Prices)*, the Panel found that a minimum import price and security system for tomato concentrate amounted to a restriction under Article XI:1 of the GATT even though it did not necessarily impose quantitative limit on the amount of imports. Similarly, in *Brazil – Measures Affecting Imports of Retreaded Tyres*, 12 June 2007, adopted 17 December 2007, WT/DS332/R *(Brazil – Retreaded Tyres*), the Panel took the position that fines imposed by Brazil on importation, marketing, transportation, storage, keeping or warehousing of retreaded tyres were inconsistent with Article XI:1 even though they did not impose any kind of border restriction but rather a 'disincentive to importation'. See para 7.370. See also *India – Measures Affecting the Automotive Sector*, panel report circulated 21 December 2001, adopted 6 April 2002, WT/DS146/R, WT/DS175/R (*India – Autos*), para 7.257. See also *Dominican Republic – Import and Sale of Cigarettes*, panel report circulated 26 November 2004, adopted 19 May 2005, WT/DS302/R (*Dominican Republic – Import and Sale of Cigarettes*) para. 7.258

[301] *Colombia - Indicative Prices and Restrictions on Ports of Entry*, Panel Report adopted 20 May 2009, WT/DS366/R, Para. 7.253. Also, the Panel in *Turkey – Textiles* refused to determine the case solely based on the alleged trade effects of the measure. The Panel noted that multiple factors impact trade flows. According to the Panel, the complex nature of trade statistics means that it would be unnecessary to interpret these trade statistics and make some kind of conclusions as to the trade effects of the measure. And so no party could solely rely on the evidence of either a decrease or an increase in imports.

See *Turkey – Restrictions on Imports of Textile and Clothing Products*, Panel Report circulated 31 May 1999, adopted 19 November 1999, WT/DS34/R at paras 9.202-9.204.

to the weight of the argument and gives credibility to the WTO in the field of the oil and gas sector measures. This notwithstanding, it is submitted that merely stating that measures in the oil sector could be WTO-inconsistent based on the letters of Article XI:1 of the GATT alone without proving their trade effects, would leave the effectiveness of Article XI:1, III:4, and the TRIMs Agreement in regulating border measures and TRIMs in the oil sector in serious doubt.

The trade effect question is essentially a question of how these measures interfere with the normal interface between oil demand and supply due to their disruptive effect on both export volume and competitiveness of IOCs, and the extent to which such effects ultimately justify their scrutiny under WTO law. These measures have the semblance of what I term quasi-protectionism. And being that the WTO was designed to phase out trade protectionism through open markets, the trade effect question further attempts to determine whether the open market mandate can accommodate the economic realities of oil producing states as well as the implicit rationale for border measures and TRIMs in the oil sector.

4.3 Border Measures and TRIMs in the Oil Sector

The crude oil sector is shrouded in controversy in terms of the relationship between its peculiar trade and investment regime and the relevance of the multilateral trading regime under the WTO Agreements. Unlike the WTO regulation of international trade in commercial goods and services, there is no singular global institute, instrument or legal framework under international law that regulates the oil industry (the same goes for gas). An 'international regulation' of the oil and gas industry is almost a vague notion since regulation hinges largely on domestic management, producer-only association such as OPEC, and regional management such as the ECT, with political underpinnings rather than on the principles of reciprocation and global cooperation.

International law instruments tend to govern matters relating to oil but is limited in the actual regulation of oil. For instance, the *International Convention for the Prevention of Pollution from Ships* (MARPOL)[302] which involves pollution from fixed and floating platforms, and which can be applicable to the oil exploration platforms, generally excludes pollution resulting from "the release of harmful substances directly arising from the exploration, exploitation and associated offshore processing of seabed mineral resources"[303]. And even where there are proposed international regulation of the oil industry[304] or an actual so-called 'international regulation' of the oil industry such as '*The International Convention on Oil Pollution Preparedness, Response and Cooperation 1990' (OPRC 1990)*,[305] they limit its application only to offshore exploratory activities.[306] In fact,

[302] November 2, 1973, 1340 U.N.T.S. 184, as amended.
[303] Article 2
[304] See the Institute for Sustainable Development and International Relations (IDDRI) Working Paper on '*Towards and International Regulation of Offshore Oil Exploration'*. Working Papers N°15/2012. IDDRI, 2012. 18; Teven Rares., 'An International Convention on Off-Shore Hydrocarbon leaks?' (2012) *26 A&NZ Maritime Law Journal*; Hossein Mesmaeili., 'The Legal Regime of Offshore Oil Rigs in International Law' *Ashgate Publishing, 2001*; Michael White., 'Offshore Craft and Structures: A Proposed International Convention' (1999) *18 AMPLJ* p.23.
[305] Adopted November 30, 1990, 30 ILN 1991 (entered into force May 13, 1995). This instrument is regarded as "probably the most important international legal document that regulates pollution of the marine environment resulting from offshore oil and gas activities". See Mikhail Kashubsky, "Marine Pollution from the Offshore Oil and Gas Industry: Review of Major Conventions and Russian Law (Part 1)" (2006) 151 Maritime Studies 1, 5. See also '*Convention on Offshore Units, Artificial Islands and Related Structures used in the Exploration for and Exploitation of Petroleum and Seabed Mineral Resources* 2001'
[306] See United Nations Environment Program "Regional Seas Programme" at www.unep.ch/regionalseas/legal/conlist.htm; Convention for the Protection of the Mediterranean Sea Against Pollution 1976 (1976 Barcelona Convention); Convention for the Protection of the Marine Environment of the Baltic Sea Area 1992 (1992 Helsinki Convention); Protocol Concerning the Marine Pollution Resulting from Exploration and Exploitation of the Continental Shelf, adopted March 29, 1989, 19 EPL (1989 Kuwait Protocol).

the oil and gas industry has been branded a '*marine and industrial*' industry.[307] In part, this is true. But the vibrant onshore drilling especially in OPEC countries as well as midstream to downstream section of the industry within the territories of states is too established to be limited to offshore activities alone.

We can infer that international law regulation is more equipped for activities occurring from the continental shelve towards the sea. This leaves us answering the legal questions over regulatory practices occurring within defined territorial borders, but which have international implications. I discuss these regulatory practices below and their implications for international trade in oil.

4.3.1 Production Restriction and its Trade Effect

Production restriction thrives as the economic policy of developing countries – mainly OPEC members.[308] Debates over whether production restriction is within the WTO scope is nothing new. Another side to the debate is to deliberate on the extent to which the trade effect of production restriction has legal weight. The trade effect of production restriction has been noted to be more important to the WTO than its legal form.[309] What this means is that even though production restriction is not, legally speaking, a border measure, as long as it passes the trade effect test, that is – it contravenes Article XI:1

[307] Wylie Spicer, Deepwater Horizon: Lessons for the Offshore, 2013 Dalhousie Law Journal.
[308] Although the global impact of OPEC's production restriction is believed to be waning due to the rise in non-OPEC production, OPEC's policy is not always about price and this still makes OPEC relevant- For instance, Saudi Arabia's production policy which has seen it break from other OPEC members is aimed at moderating rather than increasing prices so as to not give incentives to developed countries to seek investments in alternative sources of energy, See Rutledge, Ian., *Addicted to Oil: America's Relentless Drive for Energy Security, (London: I.B. Tauris, 2005)*. However, OPEC's production cut is still significant in driving world oil price.
[309] Thomas Cottier, Garba Malumfashi, *et al 'Energy in WTO law and Policy'* at 16-17.

GATT, it will be WTO-inconsistent unless it can be justified under Article XX (g) of the GATT.[310]

The argument that production restriction is not 'export restriction' within the meaning of Article XI:1 of the GATT is premised on the fact that it is a restriction on the amount of crude to be produced rather than the amount to be exported; thereby bringing it outside the WTO scope and instead within the domain of sovereignty over natural resources. The argument is also that the right to produce or not to produce is a sovereign right that is not given up by accession to the WTO. However, the *problematique* is that while production restriction does not seek to restrict export of produced crude oil, it has been viewed as analogous to export quotas within the meaning of Article XI:1 of the GATT.[311] This comparison suggests production management is, for all intent and purpose, export restriction and that it thrives because the purport of production restriction is, without question, to regulate quantity levels or volumes available to export market, thereby causing a negative trade effect. Getting to justify any of these two positions would require a microscopic view of the wordings of Article XI:1 GATT itself.

It is this trade effect question of production restriction that inspire the discussions by academics and US politicians about the relationship between OPEC and the WTO. This section brings a new twist to it by proffering a two-dimensional assessment of Article

[310] Assuming production restriction is unarguably analogous to export restriction contrary to Article XI:1 of the GATT, it has been, on the one hand, sought to be justified under Article XX (g) GATT on the 'national sovereignty' argument, while on the other hand, has been argued that it does not qualify as a justification under Article XX (g) GATT. See *Waelde, T., 'International Organisations in the Energy Sector, OPEC' in* OGEL (2003). Available at http://www.ogel.org/article.asp?key=86. The argument presented here is that production restriction is either WTO inconsistent; being a measure affecting volume and not covered by the General Exception provision in Article XX (g) GATT, or is not WTO-inconsistent; being a measure limiting production and not export and so, not having a need of Article XX (g) GATT since it is outside the WTO scope altogether.

[311] *Waelde, T., ibid*

XI:1 GATT. A violation of Article XI:1 on the basis that production restriction affects volume to be exported will be an outcome arising only from a broad interpretation of Article XI:1. This is because Article XI:1 is considered both broad in scope and comprehensive in its design.[312] On the contrary, there is the view that it is immaterial whether production restriction has trade effect on export volume taking into account the spirit of Article XI:1. This view is strongly hinged on the literal interpretation of Article XI:1. These two interpretation of Article XI:1 presents a problem for the integrity of Article XI:1 GATT. As starkly opposite as both views are on the issue, this research observes that both arguments can be justified by Article XI:1 GATT, depending on whether one views the Article from the lenses of either the broad or literal interpretation.

4.3.1.1 Broad interpretations of Article XI:1 of the GATT

The first part of Article XI:1 GATT connotes a broad interpretation of the Article. It suggests that Article XI:1 is broad enough to cover production restriction – bringing it within the WTO scope. And that since the Article prohibits restrictions even in the character of production restriction, it is therefore in conflict with the GATT provision**.** The relevant part provides thus:

> "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through *quotas*, import or export licences or other measures, shall be instituted or maintained by any contracting party…".

The following points can be deduced from the three underlined parts:

(1) Any measure that is neither duties, taxes, nor any charges whatsoever, is prohibited by the GATT. OPEC's production cut is neither duties, taxes, nor other

[312] See *Japan – Trade in Semi-conductors* adopted on 4 May 1988, BISD 35S/116, para. 104*; India – Quantitative restrictions on Imports of Agricultural, Textile and Industrial Products*, adopted 22 September 1999, WT/DS90/AB/R. para 5.128.

charges, and so falls within the ambit of prohibited measures envisioned by the Article.

(2) A restriction on production affects quota produced, and consequently, a production restriction is arguably effective as a *quota* measure.[313]

(3) Assuming it is not a quota measure, and being that it is definitely not an export or export license, as long as it is not duties, taxes or charges, as earlier noted, it can be classified under 'other measures', and thus prohibited under the Article.

From the above, for a measure to be WTO-inconsistent, first, it must not fall under those measures listed in (1) above which are allowable measures; and then it must either be a quota measure, an import/export license, or any other measure. Having established that production restriction is apparently neither duties, taxes, nor other charges, we now focus on the 'quota measure' and 'other measure' elements.

(a) Quota Measure: (Production Quota or Export Quota?)

The controversy here is that there is also a distinction between *production quota* and *export quota*. While the latter is clearly in violation of Article XI:1 GATT, the former remains contentious because of the word 'production'. There have been outright emphasis on volume effect of export restriction measures such as export quotas and export taxes which generally thrive in emerging market economies, which are major producers and consumers and potentially the largest player in world energy demand in 2035, particularly in oil, yet are non-OPEC and non-OECD countries.[314]

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[313]A quota is the amount of product (Oil in this case) a country sets as volume to extract (or produce). And since production cut affects the output volume, it suggests that it is a quota measure and so captured in Article XI:1

[314] Even OPEC confirmed that the rise in world oil demand from 88.9 million bpd in 2012 to 89.7 million bpd was driven "almost entirely" by the non-OECD regions. See CFO World, 2013. Available at http://www.cfoworld.co.uk/news/financial-planning/3450147/opec-maintains-oil-production-quota-at-30-mbpd/ (Last visited November, 2013). Also, China, India and the Middle East are expected to account for 60 per cent of world energy demand by 2035 while the OECD countries' energy demand will increase by merely 3 per cent within the same period. This has followed trend whereby the share of non-OECD countries

Conversely, the argument for production restriction being a quota measure is that it has an effect on volume. It suggests that a restriction on oil production has the intention of limiting volume that would otherwise have been available for export – much so, it can be akin to export quotas to qualify it as 'export restriction' within the meaning of the GATT Article XI:1 of the GATT.[315] This view was the initial position of Desta whose position that production restriction violates Article XI:1 of the GATT on the basis of its trade effect (or consequence) on export volume reflected the broad interpretation.[316] He has, however changed his mind.[317]

Case law have provided some precedence for this school of thought. WTO Panels and the Appellate Body have in the past adopted a broad, rather than literal, interpretation of Article XI:1 of the GATT provisions generally.[318] The Panel in *Argentina- Hides and Leather* found that although actual trade effects did not have to be proven in order to establish a violation of Article XI:1, trade effects carried weight, as evidence for establishing the existence of *de facto* restriction. It stated thus; "there can be no doubt, in

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in worldwide energy demand has already increased from 36 per cent in 1973 to 55 per cent in 2010. See IEA 2012, 51.

315Waelde, T., *'International Organisations in the Energy Sector, OPEC'* in OGEL (2003), http://www.ogel.org/article.asp?key=86; *World Trade Report 2010*. Ruta Michele & Venables Anthony, '*International Trade in Natural Resources: Practice and Policy*', World Trade Organisation: Economic Research and Statistics Division, March 2012 at 24.

316 Desta, M., `*The Organization of Petroleum Exporting Countries, the World Trade Organization and Regional Trade Agreements´* (2003) 37 Journal of World Trade, 523-552

317 Desta, M., *infra*

318 Appellate Body Report, *Japan–Taxes on Alcoholic Beverages*, WT/DS11/AB/R, at 15 (Oct. 4, 1996) [Taxes on Alcoholic Beverages case]. In this case, the AB held that the fundamental purpose of Article XI:1 is to avoid protectionism, and so any measure, regardless of its form, that aims at limiting the availability of products to other countries, is a protectionist measure; See also Panel Report, *Japan –Trade in Semiconductors*, L/6309 (May 4, 1988), GATT B.I.S.D. (35th Supp.) at 152–53. Although this case related to minimum export price requirement rather than production restriction, Desta made a comparison arguing that just as production restriction are often a response to declining oil prices, so also a minimum export price is executed through the production quotas. See Desta, `*The Organization of Petroleum Exporting Countries, the World Trade Organization and Regional Trade Agreements´ supra* note 316

our view, the disciplines of Article XI:1 extend to restrictions of a *de facto* nature".[319] In *India-Auto* case, the Panel found that a measure does not have to be a border measure directly at the point of importation for it to have trade effect, and that it might include a measure which otherwise relate to other aspects of the importation of the product.[320]

(b) Other Measures

The generic nature of the term 'other measures' explicitly invokes a broad interpretation of Article XI:1 GATT. It is so wide that provided an act of State can be deemed a measure, and provided the measure is designed to restrict trade, it is covered by the WTO.[321] By this, the term '*other measures*' is for all intent and purpose, a classical example of an 'omnibus' term, thereby giving Article XI:1 of the GATT an 'omnibus clause' effect.[322] It has been suggested that because reference to 'or other measures' in Article XI provides a very extensive and possibly endless scope of prohibited measures, then the application of such measure is determined by its result rather than by the form.[323] The outcome therefore is that, 'other measures' in Article XI:1 is wide enough to capture production restriction. But such characterisation comes with its own problems and that is the problem of 'non-effectiveness' when it comes to specific applications which this research addresses.

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[319] *Argentina–Measures Affecting the Export of Bovine Hides and the Import of Finished Leather* , WT/DS155/R (Dec. 19, 2000) at para. 406

[320] *India – Measures Affecting the Automotive Sector*, panel report circulated 21 December 2001, adopted 6 April 2002, WT/DS146/R, WT/DS175/R (India – Autos), para 7.257. Again, while this relates to importation, the same principle applies for exportation.

[321] *India – Autos, ibid at* para. 7.261

[322] This makes the list of prohibited measures (subject to the exceptions) endless.

[323] McGovern, E., *International Trade Regulation* (England, Globefield Press, 1982) p. 141-142

Applying the broad definition of conflict to the broad interpretation of Article XI:1

What the broad definition of conflicts[324] set out chapter two makes of the relationship between Article XI:1 and OPEC production management regime is that even though production restriction is implemented as an exercise of a sovereign right, and Article XI:1 GATT prescribes an obligation, as long as the right creates a potential for breach of the obligation, then there is a conflict. And that the obsession with *obligations* versus *obligation* as a determinant of conflict as put forward by the strict definition of conflict[325] is impractical since production is not an OPEC obligation on States. On the heel of this analysis, production restriction would fall under prohibited measures envisioned by Article XI:1 of the GATT, and therefore, WTO-inconsistent.

4.3.1.2 *The Literal Interpretation of Article XI:1 of the GATT*

The relevant part, which is 'underlined' provides thus:

"No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through *quotas*, import or export licences or other measures, shall be instituted or maintained by any contracting party **on the exportation or sale for export of any product destined for the territory of any other contracting party**".

While the first part relates to the type of measure, this part relates to the status of the 'product'. Interestingly, Desta after some reflection seven years later, changed his view from his initial position that production restriction was akin to export restriction on the basis of its trade effect. Although he still acknowledged the consequential effect

[324] Pauwelyn, *supra* Chapter two

[325] See Jenk, *supra* Chapter two.

production restriction has on volume, his current position is hinged on his argument that the spirit of Article XI:1 of the GATT, rather than any trade effect, is paramount.[326] Apparently, his reformed view in support of the strict and literal meaning of Article XI:1 is, from my reckoning, built around this second half of the provision. He put forward three criteria that must be present for a measure to fall within the ambits of Article XI:1 of the GATT: there must be a product (i.e., the petroleum must be produced); the product must be ready for export; and the product must be destined for the territory of any Contracting Party.

From the underlined part above, it can be deduced that production cut is not within the WTO scope on the basis that:

> (1) it is a measure restricting the production of petroleum still in the ground, and so there is no product since it has not been produced;
> (2) Consequently, it does not purport to regulate the 'exportation' or 'sale for export' of petroleum since what has not been produced cannot be exported; and
> (3) consequently, the petroleum still in the ground as a result, is not 'destined for the territory of any another country'.

Application of Strict Definition of conflict to the Literal Interpretation of Article XI:1

Recall the strict definition of conflict which sees two norms to be in conflict (a) only when - they are both mutually exclusive contradictory obligations and (b) where a norm *in and of itself* contradicts another, such that they are inherently in conflict. What the strict definition points to in the WTO-OPEC relationship is that they are not in conflict

[326] Desta, M.,'OPEC Production management practices under WTO Law and the Antitrust Law of Non-OPEC Countries', *Journal of Energy and Natural Resources Law* (2010) Vol. 28 No.4. pp 439-464 at 450. In support of this position, he cited the *Final Report of the International Joint Commission, GATT* dispute *Canada – Measures Affecting Exports of Unprocessed Herring and Salmon,* as well Article 18 (1) of the ECT which relates to Sovereignty of Natural Resources.

whatsoever. This is on the basis that production restriction does not fall within the three strict criteria outlined by Desta to render it a prohibited measure envisioned under Article XI:1 of the GATT. Therefore, it does not qualify as export restriction within the meaning of Article XI:1 of the GATT.[327] The implication of this is that OPEC's production cut is outside the WTO scope.[328] Broome noted that there is difficulty in invoking Article XI:1 of the GATT to force another country to produce its natural resource.[329] Desta further argued that "to the extent [OPEC countries] only restrict production, their acts remain outside the scope of the GATT-WTO system, falling instead under the established principle of permanent sovereignty over natural resources."[330]

This view also has support in case law. An argument put forward by Canada in *United States – Preliminary Determinations with respect to Certain Softwood Lumber from Canada*, and which was though faulted on its context, is worthy of re-examination for the purpose of its content rather than its context. In an attempt to defend its 'financial contribution' to its timber industry with harvesting rights as not being a subsidy, Canada argued that since at the time of its financial contribution to the softwood industry, the timber was un-harvested, it is not 'goods' within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement,[331] and therefore its financial contribution cannot be a subsidy contingent on export performance.

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[327]Desta, M.G., *Ibid* at 450. For another general view of production restriction versus export restriction, see also Broome, S., '*A note on conflicting obligations for oil exporting nations?: Satisfying membership requirements of both OPEC and the WTO',* The George Washington International Law Review Vol.38 (2006)
[328]Desta, M.G., *Ibid*. See also, Broome, Stephen A, *ibid* at 409-436; Malkawi, Bashar H., `Disciplining the Oil Cartel: Limits of the WTO in a Case against the Organization of Petroleum Exporting Countries´ (2009) 20:6 *European Business Law Review*, 931-948
[329] Broome, S., *ibid* at p. 435
[330] *Ibid* at 455.
[331] The Article provides thus:
"1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

It should be noted that prohibited subsidies are those measures whereby the Government makes financial contributions to give advantage to its domestic industries by boosting their export performance or cause the use of domestic goods instead of imported goods;[332] a situation that has not arisen here. In supporting this argument, Canada further argued that timber is an *in situ* natural resource (i.e., not yet produced), and that since 'goods' are "tangible or movable personal property other than money; especially articles or items of merchandise (goods or services)", it therefore means that "rights to *in situ* natural resources cannot be imported or used".[333]

While the Panel admitted that the context in which the term "goods" is used in Article 1.1(a)(1)(iii) SCM Agreement confirms the broad ordinary meaning of "goods" as tangible or movable personal property other than money, it disagreed with Canada on technical grounds rather than on the content of Canada's argument as Canada appeared to have misapplied the text and misconstrued the context in which the term 'goods' <u>was used in the provision,</u> which contextually is general infrastructure and not natural resources. According to the Panel,

> We note that the text of the SCM Agreement does not in any way provide an exception for the right to exploit natural resources, and that the only exception from the term "goods or services" provided for in Article 1.1(a)(1)(iii) SCM Agreement is general infrastructure, not natural resources. Moreover, the paper referred to by Canada in support of its argument that harvesting rights are not covered by Article 1.1(a)(1)(iii) SCM Agreement, called Discussion Paper No. 6, is an "informal discussion paper" from the Chairman of the Negotiating Group on Subsidies and Countervailing Measures dated 4 September 1990, which together with six other "informal discussion papers" was circulated in preparation for the issuance of a revised version of the Chairman's draft text of the SCM Agreement.[334]

(iii) a government provides goods or services other than general infrastructure, or purchases goods…

[332] Article 3 .1 (a) and (b) of the SCM Agreement

[333] See Canada's response to questions during the first meeting of the panel in *United States – Preliminary determinations with respect to certain softwood lumber from Canada* WT/DS136/R. 2002. paras 1 and 2 (a)

[334] See Panel Report in WT/DS236/R. adopted 27 September, 2002. para 7.26.

It further stated that "*The fact that the only exception provided for in subparagraph (iii) is general infrastructure reinforces our view concerning the unqualified meaning of the term goods as used in this provision*" [335] while also noting the sacrosanct nature of proper interpretation of text in its intended context.[336] This notwithstanding, the weight of the argument that an *in situ* natural resource not yet produced cannot be imported or used in that state, and so is not yet 'goods' is a content within Canada's argument that cannot be rejected altogether. This is because an *in situ* natural resource cannot be traded in that state. Rather, the debate on this issue is whether 'goods' should be limited to products that are capable of imported (or exported) and traded across borders.

However, the panel applied a broad interpretation to the meaning of 'goods' and still found Canada's argument flawed on the basis that the fact that the lumber was not tradable did not mean they are not goods. In giving a summary of both positions which faulted Canada's argument, the panel stated holistically thus:

> In our view however, although in many cases the general word "good" may indeed be used as an equivalent of the term "products", this does not imply that this necessarily is always so, precisely because "goods" is a term with a broad and general meaning. Canada refers to certain provisions which contain the term "imported goods", and concludes on that basis that wherever the term "goods" is used in the Agreement, it refers to products which are capable of being imported and traded across borders. We find no basis for such a conclusion in the text of the SCM Agreement. Although "goods" in Article 1.1(a)(1)(iii) SCM Agreement certainly includes tradable products, <u>there is no reason to limit its meaning to only such products</u>, particularly where the immediate context in which the term is used <u>does not suggest such a limitation</u>… The "goods" in question are not imported or exported, simply provided by the government, and nothing suggests therefore that the goods in question need to be tradable products with a potential or actual tariff line.[337]

[335] See para. 7.23
[336] In considering this application an improper interpretation, the Panel agreed with the AB in *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, page 17 that "a proper interpretation is first of all a textual interpretation" *ibid.*
[337] *Ibid* at para. 7.28

We infer from the second part of this view the notion of the trade effect of such subsidy, regardless of whether the softwood lumbers were produced or not at the time of its implementation. And that trade effect is that it boosted the capacity of the timber industry to harvest the timbers, and ultimately export them to the US market so much so that the US International Trade Commission published its preliminary affirmative determination that there was a reasonable indication that the US industry was threatened with material injury by reason of imports from Canada of softwood lumber, which it traced to the alleged subsidies granted the industry in Canada by the Government of Canada.

From the aforementioned, even a strict definition of 'goods' as products produced and capable of being tradable can be easily flawed by the broad definition of 'goods' simply by introducing the 'trade effect' element. The trade effect element being that where there are 'goods' though not yet produced but potentially capable of being produced; and once produced has the potential of being traded, any measure that deliberately restricts its production so as to affect a market (volume restriction of producing country with scarcity and price increase impact in import markets), is a measure that affects trade negatively, and so should be WTO-inconsistent regardless of whether it has been produced or not.

Unlike with the broad interpretation, there is hardly any known case, except *United States – Preliminary Determinations with respect to Certain Softwood Lumber from Canada,* that has given the literal interpretation to Article XI:1. It seems the DSB is slow to declare a measure with trade effect outside the scope of the WTO. Rather it feels safer to employ a broad interpretation which may end in the measure being applicable but not in violation of Article XI:1 rather than a literal interpretation which may end in the measure not regulated by the WTO entirely. Even researchers have tolled this line, admitting that OPEC production restriction are in violation of Article XI:1 but rather justifying them under Article XX (g).[338] In my view, this justification under Article XX (g) is flawed.

4.3.1.3 Is Article XX (g) really applicable as a defence?

Tim Carey's logic behind this view is that because the Appellate Body (AB) in *United States – Import Prohibition of Certain Shrimp and Shrimp Products* mentioned 'petroleum' as an example of exhaustible non-living natural resource, then it goes to show that OPEC's methods are justified under Article XX(g) as a conservation objective for the simple fact that petroleum exhaustible.[339] This logic actually misses the point. Even though petroleum is exhaustible and even though 'conservation' or even 'relieve of critical shortage' might have the ambience of economic necessity, hardly is 'conservation' or 'relieve of critical shortage' the goal or objective of OPEC.

Nowhere in the OPEC Statute's objective is "the conservation of petroleum" insinuated let alone mentioned. Instead, production restriction as a State measure is aimed at "*devising ways and means of ensuring the stabilization of prices in international oil markets*"[340] and "*securing a steady income to the producing countries… and a fair return on their capital to those investing in the petroleum industry*"[341]. By this, three buzz phrases capture the

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[338] Carey, Tim., '*Cartel Price Controls vs. Free Trade: A Study of Proposals to Challenge OPEC's influence in the oil market through WTO Dispute Settlement*' (2009) Volume 24, Issue 4 American University International Law Review, 783-810; Broome, *supra* n 327;
[339] *Ibid* at 801-804
[340] Article 2 (b) OPEC Statute
[341] Article 2 (c) OPEC Statute

sovereignty argument within the objective of OPEC: 'Stabilization of prices' (benefit to the international community), 'steady income' (benefit to the producing country), and 'profit' (promised benefit to foreign investors).

By this, OPEC's objective is purely an economic one not an environmental one, and OPEC does not in any form, claim otherwise. I do not find the volume effect of production restriction compelling to qualify it as export restriction within the meaning of Article XI:1 of the GATT, and I find the later finding of the Panel in the *United States – Preliminary determinations with respect to certain softwood lumber from Canada* case unconvincing in its application to OPEC's production restriction on the basis that the sovereignty principle over natural resources includes the right not to produce, and such is inalienable, and I do not believe a state need to justify it under Article XX (g) provided such restriction is similarly applied to domestic production. Such right only starts to diminish once a state produces crude at the wellhead and then limits exports or when it implements local content requirement that favours local producers over internal investors, or when it makes stringent reductions on acreage allocation made to foreign investors on the grounds of environmental protection and conservation.

4.3.2 Export Ban and its Trade Effects

Export ban in crude oil was until recently the United States' domestic energy policy for decades. *The United States Mineral Leasing Act of 1920* and the *Outer Continental Shelf Leasing Act* regulates export ban in crude oil. The Act was enacted as a response to the US concerns over oil shortage after World War 1. Of significance in terms of its trade effect is that it requires a presidential waiver before crude oil can be exported. The relevant part provides thus:

> "Any domestically produced crude oil transported by pipeline over rights-of-way granted pursuant to section 28 of the Mineral Leasing Act of 1920,…shall be subject to all of the limitations and licensing requirements of the Export Administration Act of 1969 (Act of December; 83 Sts, 841) and, in addition, before any crude oil subject to this section may be exported under the limitations and licencing requirements and penalty and enforcement provisions of the export Administration Act of 1969 the President must make and publish an express finding that such exports will not diminish the total quantity or quality of petroleum available to the United States, and are in the national interest and are in accord with the provisions of the Export Administration Act of 1969…"[342]

In this case, the 'presidential waiver requirement' under *Section 28 (u) of the Mineral Leasing Act of 1920* (as amended) for produced crude to be exported, effectively qualifies as export ban. While US presidents have characteristically not exercised this waiver, President Obama in 2014 exercised his prerogative of waiver- albeit sparingly in favour of just two oil companies to export US oil.[343] More so, the US energy policy under the Obama administration sought to shift from a high net importer to fairly energy independent. The White House was however quick to state that the ease of export ban by the Commercial department was not indicative of a change in policy from the Mineral Leasing Act of 1920.[344] That all changed in December 2015 when the Congress voted to put an end to export ban.[345] But we must give a retrospective look at Section 28 (u) of the Act of 1920 in relation to its trade distortive outcome.

[342] Section 28 (u) of the Mineral Leasing Act of 1920 as amended by the Trans-Alaska Pipeline Authorization Act November 16, 1973.

[343] 'US eases oil export restriction' Available at http://www.bbc.co.uk/news/business-28030907 (last visited September, 2014)

[344] *ibid*

[345] See The Economist, 'America lifts its ban on oil exports'. Available at http://www.economist.com/news/finance-economics/21684531-light-sweet-compromise-puts-end-crude-mrket-distortions-merica-lifts (Last visited December 27, 2015)

4.3.2.1 Section 28 (u) of the Mineral Leasing Act 1920 Vs Article XI:1 of the GATT

Notwithstanding Section 28 (u), which is in effect an obligation not to export crude oil, the prerogative of presidential waiver gives potential for a *permission* to export. This prerogative does not contradict the existence of the export ban policy. It only has the character of a presidential waiver of the existing ban. As long as the executive waiver which allowed a waiver temporarily or for a particular purpose[346] did not by implication repealed the law, the Mineral Leasing Act of 1920 remains in conflict with Article XI of the GATT putting both the strict and broad definition of conflict in perspective.

By the strict definition, like Article XI:1 of the GATT, the Mineral Leasing Act of 1920 is an obligation (*obligation* vs *obligation)* and so the President does not need to act for it to be in conflict with Article XI:1 GATT. This makes it an inherent normative conflict. Also, both laws relate to the same subject matter – crude oil already produced. On the other hand, by the broad definition, they are in conflict because over the decades, Presidents not exercising their waiver gave rise to the conflict.[347]

Interestingly even though there has always been inherent conflict between Section 28 (u) of the Mineral Leasing Act and Article XI:1 of the GATT for all these decades, the ban had not sparked much controversy until recently. Perhaps that was due to US' status as the highest importer and consumer of oil. But in the last six years due to US's growing

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[346] See also Section 28 (u) of the Mineral Leasing Act of 1920 as amended by the Trans-Alaska Pipeline Authorization Act November 16, 1973.

[347] See distinctions between the strict and broad definition of normative conflict discussed in chapter 2.

status as one of the largest oil producers[348] due to improved technology in hydraulic fracturing (fracking) and horizontal drilling, controversy has been heated both over the fracking technology. According to the API (American Petroleum Institute) data, despite its increasing production, the United States still imports nearly 56 percent of the crude it consumes. This had necessitated its export ban on crude, and such ban drew backlash from other net importing countries in similar fashion with the accusation of hypocrisy since it has in the past led the challenge against OPEC's production restrictions. Strikingly, even US oil companies mounted pressure on the US government to lift its ban completely on oil export in the wake of its production expansion citing economic reasons.[349] They also threatened possible legal action against the US government before the WTO should it sustain its export ban. Interestingly, this threat against their own government was on the grounds that export ban violates the WTO rules on prohibition of quantitative restriction.[350]

Even the US Energy Secretary, Ernest Moniz, took camp with the oil companies' argument, citing a change in the global energy climate from the 1970s that necessitated

[348] At the time of writing, according to the EIA data, with the US experiencing production boom of up to about 8 million bpd in 2014 from about 5 million bpd in 2008 , it is projected to hit the same level as Saudi Arabia by 2015, and projected to be the world's largest producer of oil by 2025. See EIA Report, July 2014. See also 'US: Oil production in 2015 to be highest since 1972'. Available at http://americasmarkets.usatoday.com/2014/07/08/u-s-oil-production-in-2015-to-be-highest-since-1972/ (Last visited October, 2014).

[349]They make the case that the US could substantially increase export earnings from selling high-quality crudes abroad, and that such exports could lower global oil prices, which would bring relief for American consumers. See Business Day: Energy and Environment. Available at http://www.nytimes.com/2013/12/14/business/energy-environment/energy-secretary-voices-concern-over-dated-oil-export-restrictions.html?_r=0 Last visited December 14, 2013 . See also The New York Times 'Conflict in Oil Industry- Awash in Crude'. Available at http://www.nytimes.com/2014/02/13/business/energy-environment/an-oil-industry-awash-in-crude-argues-over-exporting.html?_r=1. (Last visited February 14, 2014).

[350] See 'Oil Industry may invoke trade to challenge export ban', available at http://www.bloomberg.com/news/2013-11-06/oil-industry-may-invoke-trade-law-to-challenge-export-ban.html (Last visited 6th November, 2013)

export ban at the time. According to him, "Those restrictions on exports were born, as was the Department of Energy and the Strategic Petroleum Reserve, on oil disruptions (referring to the Middle East oil embargo). There are lots of issues in the energy space that deserve some new analysis and examination in the context of what is now an energy world that is no longer like the 1970s."[351] Politicians also waded in.[352] Because the global demand for oil is projected to continue to increase, any future export ban on oil by a major non-OPEC oil producing country such as the US, would undermine the positive effect any increase in non-OPEC production will have on global energy demand. According to John Felmy, chief economist, American Petroleum Institute Trade Group, "Export issues are something we are going to have to address."[353] The recent lifting of the ban as well as its capacity to export is expected to put pressure on OPEC countries.[354]

4.3.3 *Trade-Related Investment Measures and their Trade Effects*

The Agreement on Trade-Related Investment Measures (TRIMs Agreement) does not regulate investment *per se.* Rather, it is designed to regulate internal measures that

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351 See 'Calls to drop 1970s-Era US Oil Export Ban Stirs fight' available at http://www.bloomberg.com/news/2014-01-08/calls-to-drop-1970s-era-u-s-oil-export-ban-stir-fight.html (Last visited January 15, 2014)

352 'Lisa Murkowski urges review of Oil Export Ban' Available at http://www.huffingtonpost.com/2014/01/07/lisa-murkowski-oil-exports_n_4554545.html (Last visited January 15, 2014)

353 See 'Oil Industry may invoke trade to challenge export ban' *supra* (This title is now outdated as export ban has been lifted).

354 This recent developments in the US that has called for lifting of the ban in oil export points to an oil revolution whereby non-OPEC oil producing countries are seeing a shift in the geographical power play, away from OPEC supply; a development which this research will subsequently deliberate on when discussion the items to be negotiated in a new energy world map. See The Times, '40 years after the 1973 Oil Embargo: The State of American Energy' available at http://www.nation.time.com/2013/10/16/40-years-after-the-1973-oil-embargo-the-u-s-is-stronger-on-energy-but-so-is-the-middle-east/ (Last visited 07 November, 2013). While the US production of oil has increased by 15% in the last five years, OPEC's share of global oil production has fallen from 52% in 1973 during the oil embargo period, to 43% today. However, while the figures are intriguing, such increase in production from non-OPEC countries as a so-called oil revolution is nothing new. Such claim was also made as far back as 1983. See Cameron, P., '*Property Rights and Sovereign Rights: The Case of the North Sea Oil*' (London; Academic Press, 1983) at 37-9.

influence investment decisions of foreign investors, which the WTO perceives will ultimately have unfavourable trade outcomes. In other words, as will be seen later on in this chapter when discussing the provisions of the TRIMS Agreement, TRIMs are internal measures with trade-distorting implications due to their inconsistency with the national treatment principles set out in Article III:4 of the GATT and/or the obligation of general elimination of quantitative restrictions set out in Article XI:1 of the GATT. In the light of these two provisions, trade-related investment measures as a prohibited performance requirement have been examined under the tenets of both investment law (that is, the linkage between performance requirements and investment incentives) and trade law (that is, their trade-distorting outcomes) as a separate but manifestly inter-related body of laws.[355] Article III:4 provides thus:

> *"The* *<u>products</u>* *of the territory of any [Member] imported into the territory of any other [Member] shall be accorded* *<u>treatment no less favourable</u>* *than that accorded to* *<u>like products of national origin</u>* *in respect of all* *<u>laws, regulations and requirements</u>* *<u>affecting their internal sale, offering for sale, purchase, transportation, distribution or use</u>*. *The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product"* (Underlined emphasis mine)

In view of Article III:4 of the GATT, the Appellate Body in *Korea – Various Measures on Beef*[356] identified three elements that must be established for a measure to be in violation of the national treatment obligation. According to the AB, to establish a violation: (a) the measure at issue must be in the form of laws, regulations, and requirements[357] (b) the

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[355] Collins, D., *Performance Requirements and Investment Incentives Under International Economic Law,* (Edward Elgar Publishing, UK, USA, 2015) 46-148

[356] See Appellate Body Report. *Korea – Various Measures on Beef. WT/DS161/AB/R, WT/DS169/AB/R 11 December 2000* at para. 133. See also

[357] In distinguishing the word '*affecting*' from the word '*governing*', it was held that the focus is not on the laws, regulations and requirements that govern the internal sale or purchase of products, but rather what is required is that the laws, regulations, and requirement *affect* the internal sale or purchase of products. See AB in *Italy – Agricultural Machinery (L/833 - 7S/60) October 23, 1958* at para 12. See also, AB in *Canada – Certain Measures Affecting the Automotive Industry*, *WT/DS142/AB/R, 31 May 2000.* para. 10.84

imported product must be 'Like Products' with the domestic products[358], and (c) such product must be accorded less favourable treatment than the domestic 'like product'[359]. Suffice to add that what makes TRIMs applicable to trade is that they must also affect their internal sale, offering for sale, purchase, transportation, distribution or use of the product. Being that TRIMs become relevant only after an investor's goods has passed through the borders and entered into the territory of the implementing state to compete with local Like products, OPEC secretariat does not consider it to have much implications for oil; especially as producing states are not currently obligated to open up their oil industry to foreign oil companies.[360] The legality of TRIMs only arises once States have on their own opened up their borders to foreign investors and then rendering them uncompetitive through laws, regulations and requirements inconsistent with national treatment principles.

Against this background, what comes to mind when discussing TRIMs applicable to the oil sector are states' *acreage allocation policy* within a PSC and the *local content requirements (LCR)*. I intend to draw attention to the huge possibility of acreage allocation being a TRIM on the basis that (1) it is a measure that seeks to influence investment decisions even though not regulating investment *per se* (2) it is enshrined in States' regulatory

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[358] For a comprehensive analysis and examination of the determinants of 'Like Products', see *EC- Measures Affecting Asbestos and Asbestos-Containing Products (EC – Asbestos) WT/DS135/AB/R. 12 March 2001* para. 96; and Van Den Bossche, P., *The Law and Policy of the World Trade Organisation: Text, Cases and Materials* (2nd ed., 2008) p. 376

[359] See Panel Report in *US – Section 337 (L/6439 - 36S/345)* paras. 5.11-5.15; See also *EC – Asbestos, Supra*

[360] Jimenez-Guerra, '*The World Trade Organization and Oil*' (Oxford, Oxford Institute of Energy Studies, 2001) at 44. The author noted that this could change if future review of the TRIMs Agreement makes it extend to areas regulating Foreign Direct Investment. And that because the current terms of the TRIMs Agreement does not extend to investments, the US perceives it as not robust enough to ensure access to host country markets, and so have preferred the instrumentality of BITs instead as they more effective and shorter way to create an investment framework rather than the long negotiations and enforcements that accompany multilateral instruments as the TRIMs Agreement. At 43.

framework and expressed in State contract with the IOCs, and (3) it could ultimately affect production capacity and export volume.

4.3.3.1 Acreage Allocation as TRIMs?

In the oil industry, an acreage is widely known as 'Contract Area'. I refer to Michael Bunter's definition of 'Contract Area' as "…an area outlined by government or the landowner for licensing for the petroleum exploration and production, to be awarded to an oil company or licensee under one agreement, contract or license for a specific term or terms".[361]

In providing an industry account of success stories of the implementation of allocation system based on five-minute gridding Greenwich Coordinates, and beginning with the Libyan Petroleum Law of 19 July, 1955, he noted two key elements of the system. Firstly, in some early cases, it was IOCs that defined the acreage to be explored,[362] but following the transition from concession contracts to control by NOCs, decisions on acreage allocation now widely sit with host governments.[363] Secondly, the lease for exploring a Contract Area is accompanied by Relinquishment provisions which require IOCs to return unexplored parts of the Contract Area back to the government so that the used areas are efficiently explored. Instead, Work Commitment was required of the IOC for the contract area, failing which they had to relinquish those areas. For instance, Libya's

[361] Bunter, A.G.M., 'The Promotion and Licensing of Petroleum Prospective Acreage', *The Hague, London, New York; Kluwer Law International,* 2002 at 178 and 180.
[362] The 50/50 profit-sharing principle initiated in 1948 by the Venezuelan government, followed by Saudi Arabia in 1950 and adopted across developing countries, only increased the government profit margin from profit oil. The IOCs retained control over both operations, which included acreage management, and petroleum pricing. See Duval, C., *et al,'International Petroleum Exploration and Exploitation Agreements: Legal, economic and policy aspects* (2nd ed, New York, Barrows, 2009) at 45
[363] Indonesia did not refer to its acreage allocation system as a 'concession'. Rather it simply called it 'Contract Area' awarded under an Exploration and Production Contract (that is, the Indonesian PSC).

Petroleum Law divided the country into 4 petroleum zones with different prospectivity.[364]

One of the key success of the Relinquishment provision is that it can be effectively policed by the government through a process of acreage size reduction from the original acreage size, and this prevents the problem with early Concession Agreements whereby unused large acreage over a very long period meant land areas that could have been maximized were idle and trapped in long term contracts lasting for as long as 99 years.

It should be noted however that since it was the case that Contract Area allocation was traditionally made by IOCs, the issue of competition with domestic producers did not arise. Today, with governments controlling allocations and with local producers also competing for acreage, we must wonder whether there are evidences of favourable treatment accorded local producers when allocating acreage with the aim of boosting local production pursuant to local industry development objective.

On the one hand, it can be argued that since there is no ideal standard international size for Exploration Contract Areas, an acceptable system would be one whereby each country as a sovereign state under the auspices of the PSNR principle decides its acreage size allocation.[365] On the other hand, it can be argued that the exercise of this prerogative must comply with the national treatment principle. The national treatment principle requires that once a product, service or piece of intellectual property has passed through

[364] Zone I - all of Tripolitania, Zone II - northern Cyrenaica, Zone III - southern Cyrenaica, and Zone IV – all of Fezzan.
[365] Bunter, A.G.M., *Supra* n 361 at 156 and 183.

the borders into the market, they should be accorded equal treatment with locally produced product, service or piece of intellectual property.[366]

Allocation of marginal fields with preference for local companies, like in the case of Nigeria, essentially points to a violation of the national treatment principle. A concern of IOCs has been that their interests may be on the line when allocating acreage, and that a way to ensure their protection is that their Contract Area must contain at least three prospective blocks within the Area to enable them meet exploration targets.[367] It is doubtful how governments can actually determine prospectivity before allocation, since commerciality declaration comes only after seismic and exploration activities have led to a discovery following an allocation. More so, political risks are externalities that undermine prospectivity.

Historically, the allocation of extremely large, and long term Contract Area to IOCs was on its face, very attractive allocation. Over the years, such allocations have had the negative effect of local disapproval and strained relationships between the government, IOCs and local indigenes; with the feeling that they simply put a huge part of national wealth in the hands of a single licensee.[368] Hence, following management take overs by NOCs, and in countries like Nigeria where local content requirements are rife in marginal field allocations whereby private domestic investors now bid for exploration licenses are given preferential treatment, the paradigms has shifted.

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[366] Article III GATT, Article XVII GATS, and Article III TRIPS respectively

[367] Bunter, M., *Supra* at 184.

[368] In Iran, the Anglo-Persian Oil Company in 1901 was allocated as much as 480,000 sq miles, which accounted for half of the entire national territory, and this led to bad relations between the locals and the Iranian government and IOC combined.

It may then follow that smaller allocations have reduced chances of geological success. A discriminatory acreage allocation will then be a situation where allocation is not made on equal terms, or relinquishment requirement is more stringent for IOCs than for local producers. It may be the case that even a larger Contract Area with a short relinquishment time line could still be unattractive. Also, political risk is itself a major denominator in determining prospectivity – or attractiveness, such that even fields with more generous relinquishment requirement could be less attractive.

Impact of Acreage Allocation on oil investment and trade.

A key feature of acreage allocation is that States can rescind the allocation anytime during the life of the contract. Simply put, 'Expropriation'. Expropriation is a central regulatory tool in the hands of producing states to take control of their petroleum industry, and the effect of expropriation on oil markets is huge in terms of restraint on investment certainty, and uncertainties affect export capacity. Examples of fluctuations in acreage allocation and expropriation is the case of Mexico as shown below:

MEXICO (Expropriation)

1876 to 1911	-	Domination of foreign investors in mining, banking, railroad, electricity and oil industries.
1917	–	Expropriation Revolution from 1910 leading to 1917 constitution. Article 27 vested original ownership of all lands, waters and NRs in the Mexican State. Foreigners to be granted right to own and operate for exploitation of NRs subject to their agreeing to the "Calvo Clause"- i.e., they would be Mexican nationals and could not invoke the protection of their home governments upon a penalty for forfeiture of their property.
1938	-	Expropriation of oil concessions
1940 to 1958	–	Mexico pursued a more open policy towards foreign investment, permitting foreign companies once again to drill for oil.
1958	-	Under President Lopez Mateos: Amendment of the law to prohibit granting and continuation of oil and gas concessions. Exploitation exclusively reserved to State.
1982	-	Mexican debt crises needed foreign investment to thrive again, so relaxed policy.
1989	-	Issued Foreign Investment Regulations as a very liberal instrument.

1994 - Joined NAFTA (Chapter 11 provides substantial protections for Canadian and US investors in Mexico)

4.3.3.2 Local Content Requirements as TRIMs

Besides production restriction in developing countries, export ban in the US (now lifted), and the tacit discriminatory acreage allocation in a PSC, a central piece of legislation that has increasingly gained prominence in the oil sector in developing countries is the local content requirement.[369] Whilst it is classed as WTO-inconsistent, developing states have the latitude to implement them under the current international economic order.[370] LCRs are trade-related invested measures (TRIMs) which do not purport to limit the importation (or exportation) of products, and so the implications may not, so far, be clear-cut in the petroleum upstream sector.[371] This section does not intend to prove otherwise. Rather, it seeks to explore the possible link between local content requirements measure and trade distortion of crude oil, even on crude oil export.

4.3.3.2.1 Definitions and implications for oil trade and investment

Several definitions are accorded to the Local Content Requirement (LCR). The Financial LCR have been defined as provisions (usually under a specific law or regulation) that commit foreign investors and companies to a minimum threshold of goods and services that must be purchased or procured locally.[372] From a trade perspective, in strategic

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[369] Besides Nigeria and Russia where it has been passed into a full-fledged law, other strategic countries such as Brazil, Ghana, and Angola are on the verge of passing local content requirement into law.
[370] Veloso, F., 'Local Content Requirements and Industrial Development Economic Analysis and Cost Modeling of the Automotive Supply Chain' *Massachusetts Institute of Technology*, 2001.
[371] Jimenez-Guerra, supra n 355
[372] WTI Advisors, '*Local Content Requirements and the Green Economy*' an Expert Paper presented in Geneva at the Ad hoc Expert Group Meeting on 'Domestic Requirements and Support Measures in Green Sectors: Economic and Environmental Effectiveness and Implications for Trade' 13−14 June 2013. It defines LCR from a trade perspective as "*import quotas on specific goods and services, where governments seek to create market demand via legislative action*"

sectors with large economic rents involving a wide range of suppliers within the production chain particularly the oil and gas sectors, LCR substitutes imported inputs with domestic value- by this, it seeks to attract foreign direct investment (FDI) by firms; aligning investment attraction with industrial development for local industry.[373] By such alignment, governments seek to achieve developmental goals without sharing the risk of commercial undertakings.[374]

The clearest definition yet, of local content requirement can be found in the Illustrative List of the Agreement on Trade-Related Investment Measures (also known as TRIMs Agreement). It defines LCRs as follows

> "trade-related investment measures which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require: (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or (b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports." [375]

This definition will be discussed in larger details later on in this section, but we note that this definition makes reference to 'volume', and the link between LCR and trade distortion in the oil sector is its effect on volume.

Being that the WTO prohibits Member States from applying any measure that discriminates against foreign product, then the 'national treatment' provision in Article

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[373] Although used across other sectors by both developed and developing countries, its introduction in oil and gas-rich developing countries is not well received in the net consuming developed countries, being that their oil and gas corporations are at the receiving end of *quasi expropriations* as a result.
See UNCTAD 2003. For a comprehensive understanding of the Local content regime in the oil and gas industry, see IPIECA, '*Local content strategy: A guidance document for the oil and gas industry'*, 2011. See also, Silvana Tordo, Michael Warner, *et al*, *'Local Content Policies in the Oil and Gas Sector'*, July, 2013.
[374] See UNCTAD 2003. *Ibid*.
[375] See Item 1 (a) and (b) of the Illustrative List of the TRIMs Agreement.

III:4 of the GATT must be used to test the existence of LCRs, given that discrimination against foreign product is the major feature of LCRs. And since LCRs qualify as a measure within the meaning of Article III:4 of the GATT, the elements in Article III:4 must be captured in the definition of LCRs, and these pieces of definitions reflect those basic elements. Financial Times incorporates some elements of Article III:4 into its definition. It defines LCR as "the <u>requirement</u> that <u>materials and labour</u> from foreign sources used in the production of a product <u>locally be replaced</u> with materials and labour from local sources in the production of <u>that same product</u>".[376] From the underlined we can appreciate that

(a) the measure in question must be a "requirement";
(b) "materials and labour" are products;
(c) Foreign products are accorded less favourable treatment when they will "locally be replaced"; and
(d) "that same product" suggests that both the domestic and foreign products are 'like products'.

While the discussions on what constitutes 'laws, regulations or requirements', 'like products', and 'less favourable treatment' are inherent when discussing Article III:4 of the GATT, this section; even though it raises these issues nonetheless, does not focus on the legal details of those discussions. Rather it narrows itself to identifying these elements in the oil sector, and more importantly, the effect it has on the "offering for sale, transportation, and use of the product". In other words, it is concerned with the extent to which they distort or negatively impact on international trade in petroleum (i.e., their trade effects).

[376] See Longman Business English Dictionary; Financial Times Definition

Putting all the above elements in context, I offer here a summary definition of local content requirement in the context of oil as an *obligation [requirement] expressed in the form of contract, on foreign investors engaged in the production of a product or input towards the production of a product, within the territory of a host State,* to use a *specified amount of domestic inputs* in the form of *labour, services, and machinery*, for which the foreign investor's entry is *contingent upon its compliance*; and such compliance *affects the foreign investors' output and export of the product*. I assert that while this definition has general application of LCR in ever sector it is applied, it is most suitable when considering the nature of LCRs in the oil sector. Although the LCR buzz is most felt in the oil sectors of developing countries, this is simply because they are major producers and so there are credible concerns over the ripple effect a LCR in oil has on foreign investors and energy security in export markets.

4.3.3.2.2 LCR in the oil sector: Harmless in the past. Why the hysteria today?

Historically, the local content requirement was first pioneered in developed countries as a measure aimed at development of local industries and capturing of value from such developed industry. Norway implemented it from 1965 till 1994 before relaxing it after joining the EEA and the WTO. At the time of joining the EEA and the WTO, its local industry was already developed with the local content requirement playing a major role. After the UK entered the EU and acceded to the WTO, it relaxed its local content requirement by 60-70% and expanded Competition.[377] In the UK, although informal Local Content strategies through local authorities still exist, it is not significant.

[377] See the Local Content Report of Western Australia, May 2011 for a description of the strategic percentage increase of LCRs in Russia and the high LCR percentage in the *Nigerian Content Bill 2003* and the *Oil and Gas Industry Content Development Act 2010 of Nigeria* compared to the UK and Norway

Apparently, following the strengthening of local industries in developed countries which were strong enough to compete internationally, the need for international economic cooperation through the opening of borders to foreign investment heightened. And as the ideals of competition (most favoured nation, national treatment, and transparency) enshrined in both EU and the WTO became sacrosanct to member States, the need for LCRs diminished- albeit to a minimum.

On the flipside, unlike developed countries where LCR did not raise concerns as it was normal prior to joining international economic treaties, as developing countries joined the WTO, their implementation and commitment to LCRs have rather increased. Of course, prior to joining the WTO, unlike the West, their local industry capacity had remained undeveloped, and to them, joining the WTO was no hindrance to accomplishing industrial development, regardless of the TRIMs Agreement and Article III:4 of the GATT that make LCR WTO-inconsistent. The implementation of LCRs in developing countries, even though similarly about domestic industrial growth and capture of value, draws deep concerns from the developed world particularly with their implementation in the oil (and gas) sector.[378]

The concern is not surprising. Developing countries account for about 75% of global oil and gas production, and they have little or no developed competition law to ensure non-

[378] Local Content requirements in the oil sector in developing countries include the following: The full-fledged Nigerian Local Content Act (The Nigerian Oil and Gas Content Development Act of 2010); Brazil Local Content Policy ratified for exploration and development of the pre-salt oil reserves in 2003; the Indonesian Local Content Requirement provision under the Ministry of Indonesia's Technical Guidance of Usage of Local Production Regulation 49 of 2009; Ghanaian Petroleum (Local Content & Local Participation) Regulations, 2013 (L.I. 2204). In Equatorial Guinea though, LCR is however not developed as a full-fledged law. Equatorial Guinea's LCR is encompassed by a LCR clause within the larger body of law. See The Hydrocarbon Law of 2006.

discrimination of foreign investors. As at 2011, about 22 countries have enacted local content requirements.[379] The Indonesian LCR regulated by Article 79 of the *Presidential Regulation No. 35.2004,*[380] is notorious as one of the most aggressive LCR policies as shown in table 1 below.

Table 1: Indonesia's New Local Content Targets and Roadmap

Oil and gas activity	Current Target	New Target	Implementation Period
Drilling	30% (land) 35% (sea)	70% (land) 45% (sea)	After 2016
Offshore EPCI	35%	45%	After 2016
Shipping Services	35%	75%	2013
Survey, Seismic and Geology Studies	35% (land) 35% (sea)	90% (land) 35% (sea)	After 2020
Other services	35%	75%	After 2020

Culled from *Hadiputranto, Hadinoto & Partners. Finance and Projects: Jarkarta.* April 2013.

As at the time of its coming into effect in 2009, Badan Pelaksana Kegiatan Usaha Hulu Minyak Dan Gas Bumi (BPMIGAS), the defunct oil and gas regulatory agency of Indonesia set the local content target at 20%. As at 2011 it projected its local content requirement to be as high as 91% in 2025 to be accomplished in a sliding scale. In that

[379] Chamber of Commerce and Industry, Western Australia, Local Content Policy Position'. February 2011
[380] It provides that contractors must '*prioritize*' the use of domestic services, technologies, and engineering and design capabilities.

same year, it increased its LCR to 51%, up from 35%. Following BPMIGAS' dissolution in 2012 by the Indonesian Supreme Court[381], the Ministry of Energy and Mineral Resources (MEMR) by the MEMR Regulation No. 15 of 2013 set a new roadmap with a general LCR target set at 75% after 2020.[382] In fact, the most notable mention of LCR in the oil sector before the WTO is the US and EU's questioning of Indonesia's local content policy at the meeting of the WTO's Council for Trade in Goods. A development that forced Indonesia to brace up for its defence of its extensive LCR before the WTO on the grounds that it is within its legitimate prerogative to support local business.[383]

Other key countries whose LCRs in the energy sector have caused concerns with developing countries are Brazil, Russia, and Nigeria. Brazil's LCR is also robust. Brazil currently produces 2.7% of world oil production.[384] Brazil has actually made LCR a centrepiece of their industry policy affecting virtually all their industries.[385] Russia's production sharing agreements for Sakhalin 1, Sakhalin 2 and Kharyaga oil and gas projects require 70% local content for equipment and 80% for labour and this has been described as tantamount to nationalism.[386]

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[381] The dissolution was on the grounds that BPMigas regulator gave too much autonomy over Indonesia's natural resources to foreign companies.

[382] See '*Finance and Projects, Jarkata*', Hadiputranto, Hadinoto & Partners, April 2013. The 75% comprise of: 70% LCR on land drilling and 45% sea drilling after 2016 (initially 35% apiece respectively); 45% offshore EPCI after 2016 (initially 35%); and 75% of shipping services at 2013 90% for land and 35% sea for survey, seismic and geology studies after 2020 (initially 35% apiece respectively)

[383] '*Indonesia to defend local content policy on oil, gas, and mining at WTO*' Global Times. November 22, 2012. Available at http://www.globaltimes.cn/content/739701.shtml (Last visited September, 2014)

[384] See BP Statistical Energy Review, 2013

[385] Brazil-U.S. Business Council, "A Greater Brazil? Industrial Policy, Competitiveness, and Growth" (Brazil-U.S. Business Council, 2012), 5, http://www.brazilcouncil.org/sites/default/files/17875_BrazilReport_Final.pdf.

[386] Government of Western Australia, Department of State Development, Department of Commerce: Local Content Report, May 2011. p. 18-20

4.3.3.2.3 The 'LCR-Export volume' trade link in the oil sector

Much has been said of the 'trade-distorting' nature of local content requirement in the oil sector. But for the purpose of this research, how does a measure that does not directly purport to restrict exportation of oil translate into a measure that actually distorts export volume? The trade-effect of LCRs has been identified from various sources. LCR has even been described as 'Localization Barriers to Trade' (LBT) as a form of non-tariff measure (NTM) which includes "forced local production…as a condition of market access."[387] Without question, the hysteria over LCR in the oil sector (and gas) of developing countries is due to the correlation between the commercial significance of oil and gas in developing countries and distortion of IOC's export capacity of volume to their home countries resulting from LCRs in developing countries. Hence, investment restrictions through LCR in favour of local inputs to a large extent means IOC's diminished ability to so export.

Reports of analysts estimated that local content requirements affected almost $928 billion of total global trade in goods and services in 2010, or about 5 percent of the $18.5 trillion of total global trade, and that the actual reduction of world trade on account of new local content requirements amounts to $93 billion annually and that almost 3.8 million jobs are affected by LCRs.[388] It is not clear how much LCR in the oil sector has affected oil

[387] Stephen J. Ezell, Robert D. Atkinson, and Michelle A. Wein, 'localization barriers to Trade: Threat to the Global Innovation Economy' *The Information Technology & Innovation Foundation* (ITIF) September 1, 2013. Generally speaking, the authors noted that NTMs; local content requirements being one of them and which are "the most common and fastest growing form of localization barriers to trade", are trade-distorting measures erected to counter the effect of WTO's reduction in trade protectionism achieved through removal of tariff-based barriers to global trade in the past three decades; an accomplishment which has seen tariff rates reduced from 26 percent in 1980 to less than 7 percent in 2013. At pages 2 and 6

[388] Gary Clyde Hufbauer et al., 'Local Content Requirements: A Global Problem' in *Washington, DC: The Peterson Institute for International Economics*, September 2013), xxi. Cited in Stephen J. Ezell, *et al. ibid* at 9

export volume, but there are indicators that LCR in the oil sector affects oil export volume. Experts in FDI & Resource nationalism have observed that *resource rich countries with weak political institutions with high political risk and where resource nationalism is rife does pose constraints to FDI, and these constraints potentially affect the supply of oil and gas.*[389] More so, factors present in developing countries such as limited infrastructure, small industrial base, high interest rate, quality skills shortages, and high running cost as a result of these limitations could mean that Local Content requirement in a high capital intensive sector as the energy sector could have a negative effect on product output.[390] From the US's point of view, any requirement on technology transfer is a measure that distorts trade since the effect of such measure is that over time, such forced transfer of technology would transfer to the host country the capacity to locally produce the products it would otherwise have imported were it not for the technology transfer requirement.[391] It would also have the effect of restricting the exportation of such products in other to meet local consumption or just to keep output capacity within territorial boundaries.[392]

4.3.3.3 Implicit Measures constituting Local Content Requirement in the oil sector

In the oil and gas sector, an interpretation of domestic regulation of investments in the production of oil and gas must first ask the question - is the purpose of the regulation to influence production input in favour of domestic production? And does the provision of

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[389] Kretzschmar, G. L. *et al*, 'Resource Nationalism: Limits to Foreign Direct Investment', *The Energy Journal,* 2010 at 45
[390] The Local Content Report, of Western Australia, May 2011 *supra.* See also IPIECA 2011. Local content strategy, A guidance document for the oil and gas industry. IPIECA webpage: IPIECA.
[391] Greenaway, D., '*Trade Related Investment Measures: Political Economy Aspects and Issues for GATT*'_(1992) World Economy at 375.
[392] *Ibid*.

labour/machinery and expertise for the purpose of production qualify as products within the meaning of Article III:4 GATT? If the answer is in the affirmative, then it must consider whether the foreign labour, exploration and production machinery are 'like products' with the domestic labour/machineries used in the exploration and production. And finally, it must ask – 'whether the conditions of investment mean that the investors' use of their labour/machineries are treated less favourably than local investors' use of labour/machinery in producing the same petroleum. Answering all these in the affirmative implies the existence of local content requirement even though local content requirement does not purport to restrict the importation of foreign products into the territory of the implementing country.

4.3.3.3.1 Divestment of Majority Ownership to Local Subsidiaries

One of the ways LCR operates in the oil sector is through 'shareholding ownership'. A typical example is, again, the Indonesian local content rules. Its principle was that "local" content was the threshold to invest and operate in Indonesia. It states that goods and services of companies without majority-ownership Indonesian shareholding would not meet the local content criteria to operate within Indonesian territory. And for any foreign-owned energy service company to qualify as "local" content in other to meet that criteria, they would have to divest majority of their ownership. The effect was that foreign energy services companies were placed at a disadvantage compared to Indonesian-owned companies engaged in 'Like' activities, which could more easily meet the local content requirements criteria.

4.3.3.3.2 Work Commitment obligation

While work commitment obligation is a form of performance requirement, trade lawyers hardly view it as a TRIM. Initially, after states gained independence and control of their resources, the opening up of their petroleum sector to foreign enterprise and transfer of some petroleum acreage from state oil companies to IOCs following a successful bid was met with some resistance from older and senior personnel of the state companies due to feeling of loss of power. Indeed, the licensing process came with political infighting.[393] This situation was somewhat mitigated by IOC-NOC partnership in joint projects whereby states acquired interest in ventures.[394] But again, that era changed. With domestic upstream companies now competing for exploration and production licenses, IOCs now have to deal with competition from domestic investors and not just partnership with NOCs.

Work commitment is the threshold prescribed for investors to maximise their allocated acreage within the terms of the exploration contract towards making discoveries which is then accessed further for commercial quantity. And the failure to accomplish discovery within timescales as spelt out by the contract amount to relinquishment of the areas. And with domestic investors now competing for acreage alongside foreign investors, a 'favourable treatment' within the meaning of Article III:4 of the GATT will arise whereby less stringent work commitment obligation is accorded domestic investors compared to that accorded foreign investors.

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[393] Bunter A.G. Michael, *supra* n 361 at 189
[394] Duval, C., *et al supra* n 361 at 9

4.3.3.3.3 Contracts terms and conditions in Petroleum Agreements

Beginning from the 50/50 profit-sharing formula initiated by Venezuela in 1948 whereby host country and IOCs have equal share of profit oil excluding royalties;, the advent of NOCs, and the introduction of Risk Service Agreements, Production Sharing Agreements (or contracts) which was instituted by Indonesia, have come to become the most favoured form of contract for producing countries. However, the passing of the extreme local content requirement in Indonesia into law have meant that IOCs and foreign energy service companies' ability to make successful contract bids have been undermined.

4.3.3.4 Case Law interpretation of the trade effect of LCR and implications for oil

There are opposing views from Panels regarding the relevance of trade effect of internal measures to bring them in violation of Article XI:1 GATT. The Panel in *United States - Taxes on Petroleum and Certain Imported Substances*, was of the view that Article III:4 of the GATT (which prohibits local content requirement) can be linked to Article XI:1 to render internal measures having trade effect to be WTO-inconsistent. According to the Panel, "the rationale behind Article XI:1 and III:4 are essentially the same."[395] But the Panel in *Colombia – Ports of Entry*, was more cautious. It evaluated internal measures based on 'their design' and their 'potential to adversely effect on importation' and that the test of whether the ports of entry measure is a restriction on importation within the meaning of Article X1:1 should be based on "whether the measure has a limiting effect on

[395]L/6175 - 34S/136, adopted on 17 June 1987

importation by negatively affecting the competitive opportunities available to the products in question".[396]

The TRIMs Agreement[397] and Article III:4 GATT becomes particularly relevant, and Local Content Requirement especially falls within measures anticipated by Article III:4 of the GATT as a trade distorting measure.[398]

Notably, the provisions of Article III of the GATT does not require the existence of any trade effect for it to be violated. This rule occupies an important place in the rules governing the multilateral trading system being that it serves, *inter alia*, as a guarantee member states adhere to negotiated tariffs.[399] That said, for local content requirement to be inconsistent with the WTO Agreements, it must violate Article III of the GATT. And the WTO Agreement recognises that the broad purpose of Article III of the GATT is to avoid protectionism.[400] The Appellate Body in *European Communities-Measures Affecting Asbestos and Asbestos-Containing Products (EC-Asbestos)* in reiterating this held that (1) in interpreting Article III:4 of the GATT, it is essential to take explicit account of the policy in Article III:1 that measures should not be applied "so as to afford protection to domestic

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[396]*Colombia - Indicative Prices and Restrictions on Ports of Entry*, Panel Report adopted 20 May 2009, WT/DS366/R, Para. 7.253. According to the Panel, the complex nature of trade statistics means that it would be unnecessary to interpret these trade statistics and make some kind of conclusions as to the trade effects of the measure. And so no party could solely base rely on the evidence of either a decrease or an increase in imports. See para. 7.253. Also, the Panel in *Turkey – Textiles* refused to determine the case solely based on the alleged trade effects of the measure. The Panel noted that multiple factors impact trade flows. See *Turkey – Restrictions on Imports of Textile and Clothing Products*, Panel Report circulated 31 May 1999, adopted 19 November 1999, WT/DS34/R at paras 9.202-9.204.

[397]Annex TRIMS Agreement (illustrative list) and See Para 1(a) of the Illustrative List in the TRIMS Agreement. This provision classifies LCR as 'prohibited measures'

[398]For a discussion on the features and scenarios of local content requirement, see Greenaway, D., *supra* n 391 at 375.

[399] See *Indonesia-Automobiles. Infra* Panel Report. para 14.28.

[400] Appellate Body Report. *Japan -Taxes on Alcoholic Beverages* WT/DS8/AB/R; WT/DS10/AB/R; WT/DS11/AB/R (1996) at p. 16

production".[401] But then what is so bad about protection of domestic production that the WTO had to prohibit it? If States have a prerogative to move their economies up the value chain toward higher value-added activities such as advanced manufacturing and establishment of economic development through boosting of local industries production capacity translating into local jobs, what can possibly be wrong with this? The answer lies in the *adverse effect* the restrictive measure has on trade rather than its mere *trade effect* (i.e., that it has trade outcome). That distinction should be clear.

To arrive at the adverse effect of local content requirement, there must be seen to be a link between an internal investment measure focused on the protection of domestic production and its negative trade outcomes. In other words, for a trade-related investment measure to be prohibited, it must relate to and then affect export or import volume ('export volume' for the purpose of this research). The TRIMs Agreement ostensibly presents that link. Article 2 (1) of the TRIMs Agreement provides thus;

> 1- *"Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.*

The illustrative list of TRIMs goes on to identify those measures regarded as TRIMS under Article 2 (1) as follows:

> 1. *TRIMs that are <u>inconsistent with the obligation of national treatment</u> provided for in paragraph 4 of Article III of GATT 1994 include those which are <u>mandatory or enforceable under domestic law</u> or under administrative rulings, or <u>compliance with which is</u> <u>necessary to obtain an advantage</u>, and which require:*
>
> *(a) the <u>purchase or use by an enterprise of products of domestic origin or from any domestic source</u>, whether specified in terms of particular products, <u>in terms of volume</u> or <u>value of products</u>, or in terms of a proportion of volume or <u>value of its local production</u>; or*
> *(b) that an enterprise's purchases or use of imported products be limited to <u>an amount related to the volume</u> or value of local products that it exports.*

[401] European Communities-Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/AB/R (12 March 2001) [hereafter Asbestos or EC-Asbestos], paras 93, 98

2. *TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:*
   …
   *(c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production. (*Emphasis Mine*)*

In the light of the underlined in these provisions, **two cases stand out** as very instructive on the specific nature and structure and application of local content requirements and how they translate into trade outcomes, and how these outcomes have implications for export of crude oil. This analysis is not a referendum on the rightness or wrongness of local content in the oil sector, but rather an appreciation of how it also contributes to the changing dynamics of trade in crude oil.

4.3.3.4.1 *Canada- Certain Measures Affecting the Renewable Energy Generation Sector*

This case[402] relates to trade-related investment measures ("TRIMs") affecting imports of renewable energy generation equipment and components. While clearly not relating to exports nor to oil, the panel's finding and the thinking behind its finding have implications for TRIM in the oil sector and how the trade effect of such TRIM have implications for the WTO. This case essentially puts a spotlight on the TRIMs Agreement.

At the centre of the complainants' case was that Canada's "Minimum Required Domestic Content Level" prescribed under the FIT Programme and adopted by the Province of

[402] Panel Report, *Canada- Certain Measures Affecting The Renewable Energy Generation Sector (Canada-Renewable Energy),* 19 December 2012, WT/DS412/R, WT/DS426/R

Ontario37 in 2009 which it implemented through the FIT and microFIT Contracts, all in relation to certain electricity generation facilities utilizing solar PV and windpower technology, are local content requirements incompatible with Article III:4 of the GATT; are trade-related investment measures ("TRIMs") inconsistent with Article 2.1 of the TRIMs Agreement; and are prohibited subsidies under the terms of Articles 3.1(b) and 3.2 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). The Panel evaluated the merits of both of the complainants' claims under Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994.

Japan argued that the FIT Programme, and the FIT and microFIT Contracts, are TRIMs falling within the scope of the TRIMs Agreement because:

(a) through the operation of the prescribed domestic content requirements, they (i) "encourage investment in the production of renewable energy and associated equipment in Ontario" and (ii) by definition, favour the use of domestic over imported products (i.e. wind and solar energy generation equipment) and are thereby “trade-related”;

(b) the imported renewable energy generation equipment and those manufactured domestically are ‘like products’, because they are in a directly competitive situation in the market and there is no substantial difference between domestic and imported equipment in terms of their physical properties, end-uses, consumer perceptions, and tariff classifications;

(c) the challenged measures are "requirements" in that they are conditions with which FIT generators voluntarily comply in order to obtain an advantage;

(d) the measures "affect" the "internal sale", "purchase" or "use" of renewable energy equipment in that they provide an incentive to wind and solar PV energy generators in Ontario to choose renewable energy equipment manufactured in Ontario, and;

(e) as a result, the domestic content rules of the FIT Programme and Contracts accord less favourable treatment to imported renewable energy generation equipment than that accorded to like products of Ontario origin because they modify the conditions of competition to the detriment of imported products. [403]

[403] Para.7.71-73

On these points, Japan made the case that a TRIM will be in violation of Article 2.1 of the TRIMs Agreement when it is inconsistent with Article III or Article XI of the GATT 1994, and that since the five arguments above show that the challenged measure meets all the elements in Article III:4 of the GATT, the measures in question are inconsistent with Article III:4 of the GATT. And since they are inconsistent with Article III:4 GATT, their inconsistency with Article 2:1 of the TRIMs Agreement is also apparent being that paragraph 1(a) in the Annex to the TRIMs Agreement which describes the categories of TRIMs also includes local content requirements, which are deemed to be inconsistent with the obligation of national treatment found in Article III:4 of the GATT. [404]

The European Union, on its part, after making similar arguments with Japan, submitted that it is possible to establish that a TRIM is inconsistent with Article 2.1 of the TRIMs Agreement by either: (i) adducing evidence to demonstrate the existence of any of the situations described in the Illustrative List of TRIMs; or (ii) otherwise demonstrating a violation of Article III:4 of the GATT 1994 on the basis of the terms of that provision.[405] However, it went further to argue that whilst a demonstration that a challenged measure violates Article III:4 of the GATT is a way to prove that the measure is inconsistent with Article 2.1 of the TRIMs Agreement, it is not necessary to make such demonstration. It argued that the TRIMs Agreement is a fully fledged agreement, which applies independently to Article III of the GATT.

According to the European Union, a finding that a measure falls under Paragraph 1(a) of the Annex to the TRIMs Agreement results, in and of itself, in a finding of violation of

[404] Para.7.71-7.73
[405] Para. 7.80

Article 2.1 of the TRIMs Agreement and, consequently, in a finding of violation of Article III:4 of the GATT 1994. Thus, in the European Union's view, the Panel need not examine first whether there is a violation of Article III:4 of the GATT 1994 to then conclude that there is a violation of Article 2.1 of the TRIMs Agreement. [406] The purport of this argument is that as long as the measure can be identified in the TRIMs Agreement, it automatically violates Article III:4 GATT without the need for proof.

Canada's defence on the issue of inconsistency with Article III:4 of the GATT, was that whilst the FIT Programme is a product of laws and requirements, it is not subject to the obligations of Article III of the GATT 1994 because the laws and requirements that create and implement the FIT Programme are laws and requirements that govern the procurement of renewable electricity for the governmental purpose of securing electricity supply for Ontario consumers from clean sources, and not with a view to commercial resale or with a view to use in the production of goods for commercial sale as Article III:4 requires for a measure to be inconsistent with its provision. And as a result, it cannot be inconsistent with Article 2.1 of the TRIMs Agreement. On the heel of this, Canada argued that its local content requirement is however justified under Article III:8 (a) of the GATT.[407] Article III:8 (a) does not form part of the issues considered in the research.

The Panel finding in relation to the challenged TRIM and its trade effect was an evaluation of (a) whether the measures at issue constitute "investment" measures, (b)

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[406] Para 7.96

[407] Para 7.86. Article III:8 (a) of the GATT exempts the application of national treatment under Article III from applying to laws, regulations or requirements governing the procurement by governmental agencies of products that are purchased 'for governmental purposes' and not with a view to commercial resale.

whether they are trade-related, and (c) whether the measures at issue are inconsistent with Article 2.1 of the TRIMs Agreement because they are allegedly inconsistent with Article III:4 of the GATT. While noting Article 1 of the TRIMs Agreement which states that the Agreement "applies to investment measures related to trade in goods only", the Panel noted that the TRIMs Agreement however, does not define trade-related investment measures.[408] And so, the meaning can only be drawn from the purposive effect of Article 2.1 of the TRIMs Agreement, paragraph 1 of the Annex to the TRIMs Agreement, and possibly, Article III:4 of the GATT.

Investment

On whether the measure constitutes "investment", the Panel weighed the evidence provided by the complainants to show that one of the aims of the FIT Programme, and the FIT and miroFIT Contracts, is to encourage investment in the local production of equipment associated with renewable energy generation in the Province of Ontario,[409] and that its objectives includes enabling "new green industries through new investment and job creation"[410]

Trade-Related

Citing the Panel in *Indonesia-Autos* where it stated thus "*by definition, [domestic content requirements] always favour the use of domestic products over imported products, and therefore*

[408] Para. 7.108 of the Panel Report
[409] Japan's first written submission, paras. 298-299; and European Union's first written submission, paras. 100-102; and 151-152. A major evidence was Siemen's report that it will "allow its customers investing in commercial and solar farm applications to meet the 'minimum required domestic level' requirement by the Ontario government's feed-in tariff (FIT) program"- Siemen's Press Release, 3 June 2010, ("Siemens invests in Canada"), Exhibit JPN-102, p.1. Other firms such as Automation Tooling Systems (, ENERCON, and Niagara Region Wind Corporation also made similar statements expressing their commitments to fulfil the "domestic content requirements" administered by the Ontario Power Authority (Exhibits JPN-113 and JPN-117 respectively)
[410] Minister's 2009 FIT Direction, Exhibit JPN-102, p.1

affect trade"[411] the Panel noted that the "Minimum Required Domestic Content Level" imposed by the FIT Programme on electricity generators utilising solar PV and windpower technologies and "which compels them to purchase and use certain types of renewable energy generation equipment sourced in Ontario in the design and construction of their facilities…constitute TRIMs within the meaning of Article 1 of the TRIMs Agreement"[412] This finding simply re-asserts that the challenged measures are trade-related. Nonetheless, the Panel provides some possible link in its analysis of what constitutes "***commercial resale***" in the light of the exception provision under Article III:8 (a) of the GATT.

Canada further argued that that the Government of Ontario's purchases of electricity under the FIT Programme are not "with a view to commercial resale" because the OPA does not profit from the resale of electricity but simply recovers the cost of purchasing renewable electricity.[413] In support of this argument, it submitted that "commercial resale" means a purchase with the aim to resell for profit.[414] On the other hand, the complainants submitted that "commercial resale" means a purchase with a view to being sold or introduced into the stream of commerce, trade or market, regardless of any profit.[415]

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[411] Panel Report, *Indonesia – Autos,* para. 14.82
[412] Panel Report, para 7.111-112
[413] Canada's first written submission (DS412), para. 92; and response to Panel question No. 25(a)
[414] Canada's first written submission (DS412), para. 90; first written submission (DS426), paras. 35-39; opening statement at the first meeting of the Panel, paras. 55 and 57
[415] Japan's opening statement at the first meeting of the Panel, paras. 78 and 85; second written submission, para. 66; opening statement at the second meeting of the Panel, para. 36; and European Union's first written submission, para. 139; opening statement at the first meeting of the Panel, para. 39; second written submission, para. 135; opening statement at the second meeting of the Panel, para. 54

In finding that Canada's FIT Programme are with a view to "commercial resale", the Panel took into consideration: the 'The Memorandum of Agreement 'between the Government of Ontario and Hydro One which provides that Hydro One "will operate as a commercial enterprise with an independent Board of Directors that will, at all times, exercise its fiduciary responsibility and a duty of care to act in the best interests of [Hydro One]"; as well as Canada's acknowledgment that the rates received by LDCs allow for cost recovery and a rate of return that is "just and reasonable"[416]; and that both Hydro One and the 77 LDCs owned by the municipal governments are intended to make returns from their electricity transmission and distribution activities and/or assets on the basis of OEB-approved prices that are "just and reasonable"[417].

In clarifying that the decision is not solely based on the fact that there is profit but on the fact that "commercial resale" was an end objective of the programme, the Panel stated categorically thus:

> In coming to this conclusion, we emphasize that this does not mean we agree with Canada's understanding that a "commercial resale" will always necessarily involve profit, as there may well be situations where a resale of a product purchased by a governmental agency may not involve a profit but still may be "commercial" for the purpose of Article III:8(a) of the GATT 1994. Indeed, it is a fact that loss-making sales can be, and often are, a part of ordinary commercial activity. However, in the present factual situation, we have concluded that it is sufficient, for the purpose of finding that the Government of Ontario purchases electricity under the FIT Programme "with a view to commercial resale", that the Government of Ontario and the municipal governments not only profit from the resale of electricity that is purchased under the FIT Programme, but also that electricity resales are made in competition with licensed electricity retailers. In the light of the foregoing considerations, we find that the Government of Ontario's procurement of electricity under the FIT Programme is undertaken "with a view to commercial resale"[418]

[416] Canada's response to Panel question No. 13(a)
[417] Canada's response to Panel question No. 13(b)
[418] Panel Report, para. 7.151

The Panel in distinguishing between a violation of Article III:4 and Article XI:1 found that the 'local purchasing requirement' under the Canadian Act requiring foreign investors to give written undertakings that they would afford preference to the purchase of Canadian goods over imported goods violated Article III:4 GATT,[419] but it did not consider the measure to be inconsistent with Article XI:1 GATT since its requirement to purchase Canadian goods did not purport to restrict the importation of goods.[420]

Summary of outcome and Implication for Oil

On the face of this part of the Panel's finding, I observed that merely finding that the measure in question is an investment measures that is likewise trade-related would not be sufficient to provide a credible answer to the question of possible links between TRIMs and their actual effect on trade. Simply finding a measure to be trade-related within the meaning of Article III:4 GATT does not make the measure WTO-inconsistent, especially if there is no discernible trade outcome arising therefrom that has affected a complainant's ability or capacity, in comparison with its domestic counterparts, to sell the product. And that the situation would have been much different if the measure were not in place. In my view, if the Panel had dropped its pen at the point of ascertaining whether the measure is both an investment measure and is trade-related, it would have been a bad ruling. The Panel's further enquiry on the "commercial resale" element of the case introduced a possible trade link. Its finding that it is not the profitability of the commerce that counted but the presence of it thereof was spot on in my opinion, since trade outcomes is simply about whether the measure had an effect on trade volume.

[419] L/5504 - 30S/140 adopted on 7 February *1984.* Para 5.18
[420]Paragraph 5.14

In the oil sector, the defence of producing companies is that local content requirement is aimed at both meeting domestic consumption needs as well as creating value for the development of local industry. In fact, citing the *Canada-Renewable Energy* case in its statement, Indonesia justified its implementation of LCR on the same grounds as Canada; i.e., it is solely for government purposes and not with a view to commercial resale.[421] How true this is, is yet to be seen.

For all intent and purpose, to be actually WTO-inconsistent to fall under the scope of the WTO governance and dispute settlement, besides meeting all the other criteria in Article III:4 GATT and Article 2(1) TRIMs Agreement, a State's LCR measure must require purchase or use of domestic equipment, labour and services in ways that affects or relates to volume or value of these products, and which is disadvantageous to foreign investors' use of their own technical expertise such that their conforming to the local content requirement affects their production capacity, increases their running cost, and ultimately affects their export volume.

From this finding, once a TRIM's objective is "commercial resale", that is, for engaging in a commercial sale of the product, the TRIM has trade effect. Hence, where local investors put in a position of advantage by the local content policy engage in the commercial sale of crude oil, then the WTO rules should apply. But the mere implementation of local content requirement that does not translate into commercial sale

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421 'Oil and Gas New Rules on Domestic Content: Hard Headed Pragmatism or Impossible Dream?' *Finance and Projects: Jarkarta.* April 2013. A publication of Hadiputranto, Hadinoto & Partners. at page 4. Available at http://www.bakermckenzie.com/files/Publication/a6aaa8ec-a172-4423-bc7f-2de74d4ad609/Presentation/PublicationAttachment/05690e99-fe3f-4389-bbf9-4f33065467a4/al_jakarta_oilgasrules_apr13.pdf See link for an extensive overview of the Indonesia local content roadmap in the oil and gas sector.

of oil for export but simply to meet domestic consumption needs, may not qualify as having a trade effect that should bring it within the WTO scope.

Lastly, the last point of the Panel's finding that requirement to purchase Canadian goods did not purport to restrict the importation of goods and so does not violate Article XI:1 GATT, is also spot on because Article 2(1) of the TRIMs Agreement makes reference to inconsistency with Article III:4 OR Article XI:1 GATT. Hence, they are mutually exclusive, and the violation of one is not an automatic violation of the other, and so a State's TRIM can sufficiently violate the WTO rules because of its trade effect, even without violating Article XI:1 GATT that clearly relates to import or export.

4.3.3.4.2 Indonesia-Certain Measures Affecting the Automobile Industry

In this case (also known as *Indonesia-Automobiles*) the claim of the European Communities and the United States was that the 1993 and 1996 car programme by the Indonesian government, which set out to favour *PT.Timor Putra National (*Indonesia's domestic Car manufacturer) over foreign producing companies of the same car were trade-related investment measures (TRIMs) in violation of the provisions of Article 2 of the TRIMs Agreement, and Article III:4 of the GATT. According to the claimants, under the car programme, tax benefits for finished cars and customs duty benefits for imported parts and components were contingent on the importing countries' commitment to a requirement that they incorporate a certain percentage value of domestic cars and that the imported parts are used in cars incorporating a certain percentage value of domestic production.

On the preliminary matter of the legal character of the challenged measure, Indonesia argued that the measures in issue were subsidies and therefore governed by the SCM Agreement, and that the TRIMs Agreement is not applicable to the dispute. In rejecting Indonesia's preliminary argument, the Panel found that the TRIMs Agreement and the SCM Agreement may have overlapping coverage in that they may both apply to a single legislative act, but they have different foci, and they impose different types of obligations. And as a result, there is no general conflict between the SCM Agreement and the TRIMs Agreement. Therefore, to the extent that the Indonesian car programmes are TRIMs and subsidies, both the TRIMs Agreement and the SCM Agreement are applicable to this dispute.[422]

On the substantive matter of "local content requirement", the Panel was tasked with determining whether Indonesia's Car Programmes of 1993 and 1996 did actually have trade effects within the meaning of Article XI:1 of the GATT to bring it within the scope of the TRIMs Agreement. To ascertain a domestic legislation as having trade effects, before anything else, the Panel saw the need to consider the relationship or link between Article 2 (1) of the TRIMs Agreement and Article III:4 and XI:1 of the GATT.

In establishing the ideological link between the TRIMs Agreement and Article III:4 of the GATT, the Panel adopted the principle of judicial economy in observing that by addressing the local content requirement aspects of the measures at issue pursuant to the claims of the complainants under the TRIMs Agreement, an action to remedy the

[422] Panel Report, *Indonesia-Certain Measures Affecting the Automobile Industry (Indonesia-Automobile),* July 2, 1998. WT/DS54/R; WT/DS55/R; WT/DS59/R; WT/DS64/R. paras 14.47-14.55

inconsistencies found with Indonesia's obligations under the TRIMs Agreement would as a consequence, necessarily remedy any inconsistency found with the provisions of Article III:4 of GATT.[423] The thinking behind this finding is that even though they are both distinct provisions independent of each other such that different issues to which Article III:4 of the GATT may apply may not relate to TRIMs at all, in instances where the measure at issue relates to both, a remedy under one of the them will be sufficient without the need to revert to the other. To reinforce the exclusive identity of each provision, the Panel stated thus:

> It has to be recognized that the TRIMs Agreement, in addition to interpreting and clarifying the provisions of Article III where trade-related investment measures are concerned, has introduced special transitional provisions including notification requirements. This reinforces the conclusion that the TRIMs Agreement has an autonomous legal existence, independent from that of Article III. Consequently, since the TRIMs Agreement and Article III remain two legally distinct and independent sets of provisions of the WTO Agreement, we find that even if either of the two sets of provisions were not applicable the other one would remain applicable. And to the extent that complainants have raised separate and distinct claims under Article III:4 of GATT and the TRIMs Agreement, each claim must be addressed separately.[424]

In finding that this case is one of those cases where the issues are applicable to both the TRIMs Agreement and Article III:4 of the GATT, the Panel looked into the substantive matter on the platform of both provisions. It identified two steps that must be met for an internal measure to have trade effect so as to be WTO-inconsistent. First: It must be established to be a Trade-Related Investment Measures (TRIMs) within the meaning of the TRIMs Agreement and not just merely investment measures, and secondly, the TRIM must violate Articles III or XI:1 of the GATT.[425] However no claim was raised with reference to Article XI:1 of the GATT since the complainants limited their TRIMs

[423] Para. 14.93
[424] Para 14.62
[425] para 14.64

inconsistency claims to the aspects of the Indonesian car programmes made effective through the custom duty and tax benefits of these car programmes that would violate the provisions of the TRIMs Agreement. In determining the above two elements:

Investment Measure

With regards to the first, it further raises the question of whether the term 'investment' only means foreign investments. The panel held that it is of little relevance whether it is labelled an investment or not, and that what is important is whether it has the features of an investment and that such investment is trade-related. In arriving at this finding, the Panel closely assessed the Indonesian legislation in question to ascertain that the instrument was enacted with development of the local automobile industry in mind. It considered amongst others, Indonesia's *Decree of the Ministry of Industry announcing the 1993 Car Programme*. The Decree provides as follows:

> a. that within the framework of supporting and promoting the development of the automotive industry and/or the component industry in the future, it is deemed necessary to regulate the local content levels of domestically produced motor vehicles or components in connection with the grant of incentives in the imposition of import duty rates;
> b. that in order to further strengthen domestic industrial development by taking into account the trend of technological advance and the increase of the capability and mastering of industrial design and engineering, it is necessary to improve the relevant existing regulations already laid down;"[426]

Furthermore, the Panel cited the "considerations section" of the *1995 amendment* to the 1993 car programme which stated thus:

> "That in the framework of further promoting of the development of the motor vehicles industry and /or domestically produced components, it is considered necessary to amend..."[427]

[426] Para. 14.75
[427] para 14.76

With regard to the February 1996 car programme, the Panel also noted the 'Instruction of the President of Republic of Indonesia No.2 of 1996 Instruction for the National Car programme' titled "*The Development of the National Automobile Industry*" wherein paragraph A of the "Considering" section of *the Government Regulation No.20* stated thus:

> "that in the effort to promote the growth of the domestic automotive industry, it is deemed necessary to enact regulations concerning the Sales Tax on Luxury Goods upon the delivery of domestically produced motor vehicles"[428]

It further noted the decree entitled "*Investment Regulations within the Framework of the Realisation of the Establishment of the National Automobile Industry*" which was issued by the Indonesian State Minister for Mobilization of Investment Funds/Chairman of the Investment Coordinating Board, and which emphasized that the new measures were intended to promote investment. The fifth consideration of the decree stated thus:

> "that it is therefore necessary to issue a decree for the regulation of investment in the national automobile industry."[429]

Article 2 of the decree further stated thus:

> "In the endeavour to realise the development of such national car industry, the investment approval will be issued to the automobile industry sector with tax facilities in accordance with legal provisions enacted specifically for such purpose."[430]

In emphasizing the investment character of the programme, the panel further noted the provisions of the "*Decision of the State Minister for the Mobilization of Investment Funds/Chairman of the Capital Investment Co-ordinating Board*" which stated as follows:

> "1. That in implementing a national car industry it is deemed necessary to determine investment approval for a car industry which will build and produce a national car.
>
> 2. That in the framework of investment for the car industry, *PT.Timor Putra National* has submitted an application and working program to build a national car industry

[428] *ibid*
[429] *ibid*
[430] *ibid*

> and has obtained domestic investment approval (PMDN) NO.607/PMDN/1995, dated 9 November 1995"[431]

The Panel also noted that "improving the nation's self-reliance", and the setting up of production of national cars for "availability of huge financing", were essential to Indonesia's enactment of the *Decree of the President of the Republic No. 4267 on the Extension (June) to the February 1996;* and the "increased use of domestically produced automotive components" inspired the entering of the Indonesian *Government Regulation No. 3667 of 1996;* while "the provision of a tax incentive in the form of exemption from the assessment of Sales Tax on Luxury Goods on the delivery of certain motor vehicles which have achieved certain levels of local content" was central to the entering of the *Government Regulation No. 36.* And what is more, Indonesia outlined its 'Objective' behind the Car Programme in the Descriptive Part of the *National Car Programme.*[432]

On the heel of all these instruments, the panel found that the 1993 and the 1996 car programmes, which have investment objectives and investment features are aimed at encouraging the development of a local manufacturing capability for finished motor vehicles and parts and components in Indonesia, and that have a significant impact on investment in these sectors. Therefore, the Car Programme were investment measures.

Trade-Related

In accessing any possibility of the Car Programme hindering trade, the Panel made recourse to the Illustrative List of TRIMs in the TRIMs Agreement, particularly

[431] *ibid*

[432] Paragraph 6.51. The objective is clearly aimed at improving the development and competitiveness of local companies.

Paragraph 1 (a) to determine whether the measure in question fell within the ambit of the list to qualify as having effect on trade. In finding that Indonesia's Car Programme provided for tax advantages on finished motor vehicles using a certain percentage value of local content and additional customs duty advantages on imports of parts and components to be used in finished motor vehicles using a certain percentage value of local content, the Panel noted certain provisions of the Car Programme.

For instance, Article 2 (1) of the *Decision to issue the Decree of the Minister of Industry Concerning The Determination of Local Content Levels of Domestically Made Motor Vehicles or Components attached to the Decree of the Ministry of Industry announcing the 1993 car programme* states in part: "the Automotive Industry and/or the Components Industry <u>may obtain certain incentives within the framework of importing needed components</u>… if the production has reached/can achieve certain Local Content levels."[433] Article 2(3) of the same instrument makes reference to "Local Content levels…which are eligible for incentives".

Also, the Panel noted paragraph 1(a)-(c) of *The Instruction of the President of the Republic of Indonesia No.2 of 1996 of the National Car programme (dated 19 February 1998),* which states in part: "The Minister of Industry and Trade will foster, guide and grant facilities in accordance with provisions of laws in effect such that the national car industry <u>uses components produced domestically as much as possible</u> and <u>is able to export its products</u>". More so, a requirement for designation as a 'National Car' was that the local content rate must be at 20% at the end of the first year, 40% at the end of the second year

[433] See para 14.86

and 60% at the end of the third year, and as such, Article 1 of Number 42 of the 1996 affords only "National Cars which are made overseas by Indonesian workers and fulfil the local content stipulated by the Minister of Industry and Trade…" equal treatment to those made in Indonesia.[434]

And lastly, a very instructive instrument that points to the trade impact of the Car Programme was Article 2 of the *Decree of the Minister of Industry and Trade adopted pursuant to this Presidential Decree 42*. It stated thus, "The procurement of Indonesian made parts and components shall be performed through a system of counter purchase of parts and components of motor vehicles by the overseas company <u>carrying out the production and re-exporting</u> of national cars to Indonesia."[435]

Therefore, in finding that the *tax and customs duty benefits* introduced by the Car Programmes are "advantages" within the meaning of the chapeau of paragraph 1 of that Illustrative List, the Panel held that the lower duty rates were clearly "advantages" in the meaning of the chapeau of the Illustrative List to the TRIMs Agreement and as such, the Indonesian measures fall within the scope of the Item 1 of the Illustrative List of TRIMs.[436] The purposive effect of the general finding of the Panel is that local content requirements by their characteristics, somewhat similar to subsidies[437], give advantage

[434] See para 14.87
[435] *ibid*
[436] Para 14.89
[437] The Panel also sought to answer the question of whether the measures in issue are specific subsidies. It held that the import duty and luxury sales tax exemptions on CBU Timors imported by PT TPN from Korea, import duty exemptions on parts and components used or to be used in the assembly of the Timor in Indonesia, and luxury sales tax exemptions on Timors assembled in Indonesia are tariff and sales tax exemptions within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. Secondly, that the measures confer a benefit on PT TPN within the meaning of Article 1.1(b) of the Agreement. Thirdly, that they are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b). And lastly,

to certain companies that produce products that are *destined for export to the territory of other countries,* have an effect of limiting importation of machineries, as well as limiting the export capacity of foreign producing companies compared to their capacity without the local content requirement. This is similar effect local content requirements have in the oil sector.

Lessons and Implications for the Oil Sector.

This case clearly points to both the objective and, more importantly, the trade advantages of local content requirement on the local investors for whom the objective is designed. The measure must be one that seeks to boost the development of local industries for the *specific* purpose of gaining export advantage over foreign investors akin to an export subsidy. Hence, local oil companies favoured by LCRs are also in the business of exporting oil to foreign market, in the spirit of the panel finding, it would amount to such measure envisaged by Article 2.1 of the TRIMs Agreement, and hence WTO-inconsistent.

4.3.4 *Acts of National Oil Companies (NOCS) and their Trade Effects*

National Oil Companies (NOCs) control about 80 percent of the world's crude oil reserves and is said to account for 65 percent of the world's crude oil production with IOCs controlling the rest.[438] Astonishingly, there are over one hundred NOCs established across producing states to facilitate state participation in petroleum

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that they are therefore deemed to be specific for such purposes, pursuant to Article 2.3 of the Agreement. At para 14.155

[438] EIA 2009 *"Who are the Major Players Supplying the World Oil Market?"* www.eia.doe.gov/energy_in_brief/world_oil_market.cfm. Last visited 14 August 2014.

operations.[439] It goes without saying that the role of NOCs in states' design of the measures discussed above in this chapter is so prominent that to discuss State measures without putting NOCs in the frame would be an incredible omission.

For a measure to violate an international obligation, that measure must be applied by a state since only states can be parties to a treaty.[440] Trade and investment in petroleum agreements are mainly facilitated through NOCs-IOCs contractual relationships with a governmental regulatory framework as the platform. Violations are therefore violations of contractual obligations rather than violations of international obligations. But then, since acts of NOCs are found to constitute regulation in the fashion of measures affecting IOC's investment competitiveness with implications for export potentials, then it triggers a discussion on attributing those acts of NOCs to States. And where such acts are attributed to state, a breach of an international obligation may arise.

This section first examines how the acts of NOCs in petroleum contracts, which are not just operational but arguably regulatory in nature, could be attributable to the State for them to be considered 'measures'. Secondly, it seeks to determine whether such 'measures' have a distorting effect on exportation of crude oil – an outcome which counts for the state's violate of its international obligation under the WTO. In determining attribution of NOCs acts to states, 'the doctrine of state attribution' enshrined in the *Draft Articles on Responsibility of States for Internationally Wrongful Acts (ILC Articles of State Responsibility)*[441] becomes relevant for analysis.

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[439] Duval, *et al, supra* n 361

[440] See chapter one.

[441] Adopted at its 53rd Session, 2001 (Doc. A/56/10) at 29-235. The Draft Article though not a treaty in its own right, has by codification and usage been appraised by tribunal and international law commentators as an instrument that "accurately reflect customary international law on state responsibility". See Kaj Hober,

4.3.4.1 The State Attribution Doctrine: A definition

Under the plenary provisions of Chapter II of the Draft Article on State Responsibility, the doctrine of state attribution holds a state responsible for the conduct of organs of the state, organs of territorial Government entities, and persons acting on behalf of the state.[442] Chapter II of the *Draft Article* has its roots in the *UN General Assembly Resolution 799 (VIII) of 1953*.[443] *Resolution 799 (VIII) of 1953* was aimed at promoting the codification of a principle of international law governing state responsibility that was dedicated solely to maintaining and developing peaceful relations between states. Going by this original mandate, the phrase 'peaceful relations' connoted a policy on non-war relationships rather than commercial relationship, while the phrase 'between states' by inference appears to have excluded relations between a state and a non-state actor.

Traditionally, in commercial transaction terms, international law deals with obligations only between states, and the implication is that non-state actors cannot be liable for an internationally wrongful act arising from the violation of commercial contracts.[444] The inference of this Resolution would be either or both of two possibilities: First, a wrongful act of a state in its relationship with a non-state actor is not covered by the instrument, and secondly: only acts that have the potential to breach international peace (not commercial acts) were in focus.

State Responsibility and Attribution, in MUCHLINSKI, P., *et al*., eds., The Oxford Handbook of International Investment Law 941-2 (2008) at 553. See also *Noble Ventures, Inc*. v. *Romania*, Award, ICSID Case No. ARB/01/11, para. 69 (Oct. 12, 2005)

[442] Chapter II (Articles 4, 5, 6, 7, 8, 9, and 10) of the ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts.

[443] UN General Assembly Resolution no. 799 (VIII), Dec 7, 1953. 8th session, Official Records, Supp. No. 17 (Doc. A/2630) at 52.

[444] Walde, T., *State Responsibility for subnational authorities and non-state national entities',* 27 Netherlands Yearbook of International Law (1996) at 150

But following the adoption of the principle by the ILC, and subsequent recognition by the UN in 2001,[445] the interpretative meaning to be given to the ILC Draft Article is that it extends (or modifies) the frontiers of Resolution 799 (VIII) beyond just acts of States and beyond just acts relating to breach of peace. It now covers acts of non-State parties and any acts that breaches an international obligation generally.[446] Consequently, the AB in *Canada-Dairy* re-affirmed this principle when it found export subsidies actioned by privately-owned entities to be attributable to the state.[447] Article 2 prescribes two essential elements that constitutes an internationally wrongful act of a State to be:

> (a) when an action or omission is attributable to the State under international law, and
> (b) if that act or omission constitutes a breach of an international obligation of the State.

The spirit of (a) above is that a wrongful act (or omission) must not necessarily be directly performed by the state. Rather, the act or omission must be one which imputes liability to the state under the doctrine of attribution, regardless of whether the act was performed by a private-entity with exclusive or special privileges or a state-trading enterprise without such express privileges.[448] On the other hand, the spirit of (b) above is that it prescribes the subject of breach to be breach or violation of any international obligation whatsoever whether arising from a treaty to which the State is a signatory, customary international law, or general principles on international law.[449] The goal of

[445] UN General Assembly Resolution 56/83 of Dec. 12, 2001. (UN Doc. A/RES/56/83)
[446] Article 2 of the ILC Draft Article.
[447] Appellate Body Report in *Canada- Measures Affecting the Importation of Milk and the Exportation of Diary Products,* WT/DS103/AB/R W2, adopted on January 17, 2005, para. 95. The AB noted the provisions of Article 9.1 (c) of the Agreement on Agriculture in stating that not only the conduct of WTO Members are relevant.
[448] The attribution doctrine seems strict in this regards, as what is relevant is that there is a relationship with the state even though it is in the capacity as private-entity or non-State entity.
[449]

this section is to determine the relevance and application of these two ambits of the doctrine to measures in oil and gas sector.

The first element is less controversial than the second. In the first element, we examine the possibility of acts conducted by NOCs in the administration of international oil and gas agreements to be regulatory due to their link to national governments (*the 'attribution' element).* By the second element, such attribution then makes the state in violation of an international obligation. The difficulty with the second element lies in the fact that oil and gas law and policies largely arise from bilateral contractual relationships between states and IOCs, sometimes through the instrumentality of NOCs. And so it would be a difficult task to determine whether States' acts that affect foreign investors' capacity to compete locally or to export their share of crude may mean that such restrictions are in violation of the producing states' WTO international obligation rather than a breach of their contractual obligation (*the 'violation of an international obligation' element*).

4.3.4.2 The 'Attribution to State' element

To make the case for applying the attribution doctrine to NOCs' regulation and/or administration of international oil and gas agreements, it is imperative to understand the current scope of the doctrine and the thinking behind it. These two elements are significant to the discussion of international petroleum agreements between states and IOCs to which both the states' directly or through their NOCs play significant roles that have a ripple effect on the IOCs ability to either compete with local investors or export crude to their home state and foreign markets.

4.3.4.3 State Responsibility and State Trading Enterprise under the GATT/WTO

While the WTO treaty defines what constitutes measures, State attribution in the WTO treaty is alarmingly unclear and rarely does case law of the WTO Dispute Settlement Body invoke the doctrine of attribution to find a State liable and in violation of its obligation under the WTO.[450]. Other than a description of what might pass for a State entity, the GATT did not explicitly define what a State Trading Enterprise is, not even in Article XVII GATT dedicated to STEs. In fact, the GATT does not impose obligations on states on the use of STE's for the purposes set out in Article XVII GATT. Rather, it merely calls on states to embrace "negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles…"[451] Perhaps, the only obligation prescribed is that of transparency; that is, States shall notify others of the products they import or export through STEs.[452]

This is not sufficient to regulate the actions or trade restrictive measures of, for instance, State Oil Companies, which will pass as STEs. STE may be inferred from the GATT provisions to the extent that the terms "import restrictions" or "export restrictions" include restrictions made effective through State trading operations, without any expatiation on state trading operations.[453]

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[450] They give their attention to the provision being breached, and by so doing, exhibit the requirement of 'breach of international obligation' of Article 2 of the Draft Article without necessarily exhibiting an appreciation for the 'attribution' element.
[451]Article XXVII (3)
[452]Article XXVII (4) (a)
[453] the Ad notes to Articles III (on National Treatment), Article XI (On elimination of quantitative restrictions), Article XII (on restrictions to safeguard the balance of payments), Article XIII (on the non-discriminatory administration of quantitative restrictions), Article XIV (on exceptions to the rules on non-discrimination) and Article XVIII (regarding government assistance for economic developments)

However, to correct this defect of uncertainty as to the definition of STEs in the GATT, and for the avoidance of wide interpretations, the WTO in the Uruguay Round made subsequent effort to offer a working definition of a State Trading Enterprise to be "*Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports*."[454]

More so, the attribution doctrine can be inferred in both the GATS for the purpose determining violation. Article 3 (1) (a) of the GATS defines state measures to include "measures taken by (i) central, regional or local government and authorities; and (ii) non-governmental bodies in the exercise of powers delegated by central, regional, or local governments or authorities". NOCs cannot in the slightest be considered non-governmental, so paragraph (ii) does not serve the purpose of this research. NOCs are, as it implies, have national character, and so paragraph (i) is more applicable.

For the purpose of attribution, the Article goes further to provide that in the fulfilment of their obligation under the Agreement, each Member shall take such reasonable measures to ensure that regional and local governments *and authorities* observe these obligations. By distinguishing '*authorities*' from 'government' in this provision, we infer that such authority that is not the government *per se,* is a state entity or organ of the state at the national or regional level, given some powers by the state with the ability to

[454] See '*understanding on the interpretation of Article XVII of the general agreement on tariffs and trade 1994*' GATT 1994. Annex 1A of the WTO Agreement.

observe the obligations of the state under the Agreement.[455] It can also be inferred from the reasoning of the WTO panel in interpreting Article XXIII:1(b). The Panel in *Japan-Measures Affecting Consumer Photographic Film and Paper* held that for a claim of non-violation complaint under the provision to be made, there must be the existence of the application of a law or measures that is linked to the State.[456]

4.3.4.4 NOCs as State Trading Enterprise?

For a conduct of a non-State actor to be attributable to the state, it must fall under the category of state entity or state enterprise. And for a conduct of a state enterprise to be attributable to the state, those conducts must be done under actual or apparent authority of the state.[457] By virtue of *Article 4 of the ILC Draft Article on State Responsibility*, conducts of organs of a state envisaged by the state attribution doctrine includes legislative, executive, judicial, or any conduct exercised in the performance of other functions, irrespective of the organ's position in the state, and irrespective of its character as an organ of the central government or of a territorial unit of the state.[458] This provision entrenches vicarious liability on states for the acts of state entities exercising a function

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[455] While governments are categorised into national governments and sub-national governments such as regions, provinces, and municipalities, this research focuses on the authority of governments as national levels since they are the once who enter into international oil and gas agreements, and who have direct control over national oil companies.

[456] See Panel Report in *Japan-Measures Affecting Consumer Photographic Film and Paper,* WT/DS44/R, p.437, para. 10.41 (April 22, 1998). See also Panel Report in *Korea – Measures Affecting Government Procurement,* WT/DS163/R, p. 181, paras. 7.83-7.86, May, 2000)

[457] Christenson, 'The doctrine of Attribution in State Responsibility', *in* Lillich, R., (ed.,) *International Law of State Responsibility for Injuries to Aliens,* (University Press of Virginia, 1983).

[458] See also Article 6 of the Report of the Commission to the UN, '*Yearbook of the International Law Commission', 1974* Vol II, Part 1 . Documents of the twenty-sixth session, DOCUMENT A/9610/Rev. 1. See also, *Salvador Commercial Company* UNRIAA, vol. XV, p. 455 (1902), at p. 477; *Chattin case*, UNRIAA, vol. IV, p. 282 (1927), at p. 285-86; *Dispute concerning the interpretation of article 79 of the Treaty of Peace*, UNRIAA, vol. XIII, p. 389 (1955), at p. 438*; Difference Relating to Immunity from Legal Process of a Special Rapporteur of the Commission on Human Rights*, I.C.J. Reports 1999, p. 62, at p. 87, para. 62, referring to the Draft Articles on State Responsibility, art. 6 (now embodied in art. 4). Here, the ICJ describes the State attribution doctrine as that "of a customary character"

in the capacity as a State Entity. But the Entity or Enterprise must have a strong link to the state for the state to incur liability under the attribution doctrine.

State '*ownership*' and '*control of functions*' have also been identified as two main characteristics of State Enterprises.[459] The affiliation with the State must be either through ownership by the state or control by the state, or both. State Enterprises are generally said to have ownership (control), activity (operational), and revenue (commercial) functions.[460] NAFTA defines State Enterprises as "an enterprise…owned or controlled through ownership interest, by a Party".[461] We now determine whether NOCs fall under this definition.

Algiers Declaration of 1981 contains special rules of state attribution thus "any entity controlled by the Government" is to be considered as the Government of Iran.[462] The ECT defines State Enterprise as those entities "established or maintained" by states. But it goes further to distinguish this from what is called 'Privileged Enterprises' which according to it, are those with "special or exclusive privileges" and which includes "regulatory, administrative or other governmental authority".[463] Even a delegated authority, with less or more control of the State, given to autonomous bodies is captured by the attribution doctrine.[464] Thomas Waelde in analysing the purport of Article 22 of

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[459] Radetzki M., *State Mineral Enterprises: An Investigation into Their Impact on International Mineral Markets* (Washington DC, John Hopkins University Press, 1985). While the 'ownership' element relates to the equity holding of the government in the enterprise, the 'control' relates to the various complex factors such as the size, units, and proportions of the enterprise in correspondence with the equity share of the government.
[460] Radetzki M., *ibid* at pp 8-19. The issue here is discussed in the context of market failure and political motivations for interventionist policies that lead to creation of STEs in the mineral sector.
[461] Article 1505.
[462] Article VII (3) of the Declaration of the Government of the Democratic and Popular Republic of Algeria concerning settlement of claims by the Government of the United States of America and the Government of the Islamic Republic of Iran, 19 January 1981 ("the Iran-US Claims Settlement Declaration).
[463] Article 22 of the ECT.
[464] League of Nations, Conference for the Codification of International Law, *Bases of Discussion for the Conference drawn up by the Preparatory Committee,* Vol. III: (Doc. C.75.M.69.1929.V.) p. 90

the ECT which is quite similar in language to Art. XVII of the GATT observed that there is a distinction between state entities and non-state parties, and that the attribution doctrine applies even whereby private energy companies in dominant position who may not be state entities but which thrive due to states creating the enabling laws for them to have significant influence over foreign investors.[465]

By virtue of Article 25, the ICSID Convention extends its jurisdiction also to any constituent subdivision or agency of a Contracting State. What makes the ICSID Convention jurisdiction of particular relevance is that it deals with investment disputes between states and nationals of other States. And since IOCs are nationals of their home state for the purpose of investment protection, regulations of measures by NOCs affecting IOCs within a host state falls under its jurisdiction. The implication of this is that NOCs can be designated as agencies of States for the purpose of ICSID jurisdiction.

While definitions of State Trading Enterprises seem to point to NOCs as STEs, producing states are split over the status of their NOCs as STEs. Saudi Arabia and the United Arab Emirates indicated that they do not maintain any State Trading Enterprise within the meaning of Article XVII of the GATT 1994.[466] In contrast, Bolivian Republic of Venezuela in fulfilment of the Understanding on the interpretation of Article XVII of the GATT 1994

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[465] Waelde, T., *State Responsibility for subnational authorities and non-state national entities',* 27 Netherlands Yearbook of International Law (1996) at 143-194. In his assessment, he noted that even though dominant monopolies are not in the position to conform to international treaty obligations, by virtue of states creating, protecting or supporting these energy companies through licensing laws, the states become involved in the energy market. And that even by virtue of the investment treaty obligations in Part III directly applicable to such private energy companies, by occupying a dominant position mainly in the control over energy transportation, distribution, supply, storage and purchase facilities which are vital for a normal, competitive and fair business by foreign investors, they are under a duty of non-discrimination so that we can no longer use the commercial character and the corporate form of such companies to deny state responsibility.

[466] See Working Party on State Trading Enterprises- State Trading- New and Full Notification Pursuant to Article XVII:4(a) of the GATT 1994 – Saudi Arabia, G/STR/N/12/SAU (11 March, 2009). See also, the notification of the United Arab Emirates, G/STR/N/1/ARE.

requiring States to notify their STEs to the WTO Council on Trade in Goods, notified PDSVA- its National Oil Company, and by so doing, recognises it as a STE. The National Iranian Oil Company (NIOC) was considered part of the State as a rule in several of the Iran-US Claims Tribunal cases. More so, even the ECT recognises that the participation of exploration and exploitation of energy resources within a sovereign State can be either through direct participation by the government or through state entities.[467]

To this end, an act conducted by a state entity will or will not be attributable to the State depending on whether that act arises from a governmental activity or not, and regardless of whether it is commercial or not. This view counters the views that (a) breach of contracts by States through State entities does not entail a breach of international law, and (b) a State cannot engage in commercial activities to be liable under international law. This wide interpretation of what activities are in focus and what amounts to breach extends to the purported regulatory role of NOCs in administering International Oil and Gas Agreements.

4.3.4.5 Regulatory, Operational, and Commercial functions of NOCs

While NOCs are not generally involved in setting the terms of IPAs such as PSCs, like in the case of Russia for instance where such decision making lies with the ministry, in most cases NOCs are instruments through which governments regulate terms of IPAs. There are disparities as to whether NOCs are active players in policy-making or social vehicles

[467] Article 18 (3)

for implementing policies or mainly engaged in the commercialisation of oil and gas.[468] We must determine whether the role of NOCs are regulatory as much as they are operational and commercial, and whether their functions or actions in a State-IOC relationships are such that qualify as State measures.

The authoritative questions before us are: (a) what is the legal identity of the State entity? (b) What are their powers? and (c) what influence do they exude as a result of their powers? Taking a look back to the beginning, the first ever NOC established by the Austrian government in 1908 was established principally to process crude oil and to develop the downstream markets for petroleum products.[469] This was strictly an operational mandate. After Argentina followed suit in 1922 with Yacimientos Petroliferos Fiscales (YPF), other developed countries later established NOCs for purely operational reasons.[470]

The mid 1950s saw developing countries establishing their own NOCs, even though they had no major influence until the 1960s and 1970s post-independence era. Rather than for operational reasons, these new crop of NOCs were established as vehicles to aid the nationalization process. These NOCs featured heavily in regulatory roles, except a few like Brazil's Petrobras which was established purely for commercial purpose. States also ensured their participation in operations by fostering partnership for joint operations

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[468] For an extensive analysis on the role and strategies of NOCs in States' governance of oil, see Victor, David, G., Hults, David R., and Thurber M., *Oil and Governance; State-owned Enterprises and the World Energy Supply* (Cambridge, Cambridge University Press, 2012).
[469] Heller, C.A., '*The Birth and Growth of the Public Sector and State Enterprises in the Petroleum Industry', in 'State Petroleum Enterprises in Developing Countries* (United Nations Symposium on State Petroleum Enterprises in Developing Countries, Pergomon Press, New York, 1980)
[470] France's Compagnie française del Pétroles in 1924 and Italy's Azienda Generale Italiana Petroli (AGIP, now part of Eni) in 1926

with IOCs through their NOC's acquisition of interests in joint ventures.[471] PDVSA and Malaysia's Petronas engaged heavily in both international commercial and regulatory activities acquiring equity interests in European and American refineries, and taking ownership of CITGO an American distributor so much so that they were seen as "states within a state". [472] Gazprom in 1990 was also acclaimed as a "state within a state" due to its independence from the Russian government control and their political inclinations.[473] The fall in oil prices in the 1990s saw states limiting their control of NOCs and freeing them up for privatisation in other to be more competitive.[474]

This wave of liberalisation in the oil sector was not as rampant as in telecommunications and electricity though. Following the oil price increase, another wave of reform occurred with government not just taking control of their NOCs again, but also vesting them with social obligations such as procurement requirements, domestic gasoline subsidies, as well as spending programs, effectively making them *quasi governments*.[475]

While some governments clearly define their NOCs functions – separating policymaking from regulation, and from operations, with a purely strategic and operational autonomy; a system otherwise known as the "Norwegian model" (Statoil) and also implemented in Brazil (Petrobras), other governments have a 'hybrid governance' structure whereby

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[471] Duval, *et al* Supra n 361 at 9
[472] Boue, Juan, C., *Venezuela: The Political Economy of Oil* (Oxford University Press, 1993)
[473] Mommer, Bernard *Global Oil and the Nation State* (Oxford University Press, 2002)
[474] Argentina's privatization of YPF in 1922, Russia's sale of much of its oil sector to private sector, part of China and India NOCs' shares taken as minority shares by private investors, PDVSA lobbied its government for greater private sector role.
[475] For instance, see PDVSA's 1990 negotiations with IMF. Hults David R., '*Petroleos de Venezuela, S.A (PDVSA): from independence to subservience' in* Victor, D, G., *et al, supra* n 468 at 418-463

NOCs operate as an extension of the government or as a government agency.[476] The objectives which NOCs in hybrid governance countries pursue include employing citizens, furthering a government's domestic or foreign policy objectives, generating long-term revenue, and supplying inexpensive domestic energy.[477] Governments with a hybrid structure embody both a unified system with state control and a fragmented system with different arms having some form of control.

However, the interests of NOCs and their governments are not necessarily similar. While states with well-defined and developed institutions exert control over their NOCs from various options available[478], most states have limited or shared or fragmented mechanisms for exerting control over their NOCs despite owning the NOCs.[479] The difficult issue of ownership *versus* control is much prominent in China as one of the most complex NOC situations.

Whilst China National Petroleum Corporation (CNPC) is state-owned, the question of who really controls its corporate governance structure and internal decision making, as well as what impact the Chinese government's liberalization efforts and introduction of

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[476] Hults, D.R., '*Hybrid governance: State management of National Oil Companies*', *in* Victor, D, G., *et al, ibid* at 62-110. Hults analysed categories of NOCs in their functions as *rule setting* (unified control by government, or fragmented and shared between the head of state, executive agencies, and the legislature), *rule function* (state exerts control to approve or make NOC decisions in advance), and *rule form* (legal frameworks in place that channels or even constrain governance decisions. i.e., highly law-based or bureaucratic system).

[477] All NOCs of the OPEC countries including Pemex of Mexico fall under this category.

[478] Gazprom (Russia), Saudi Aramco (Saudi Arabia), PDSVA (Venezuela), Statoil (Norway), Sonangol (Angola), ADNOC (Abu Dhabi) and recently, Petrobras (Brazil)

[479] CNPC (China)- authority shared between the State Energy Commission and the National Energy Administration; NNPC (Nigeria)- authority shared between the president and the National Assembly in policy making, while lower level officials have ability to approve minor company decisions; NIOC (Iran)- authority shared between Ayatollah, the president, the parliament (Majlis), and the petroleum ministry; KPC (Kuwait)- authority shared between the oil ministry, the National Assembly, state shareholder representative (Supreme Petroleum Council), various state regulatory agencies; Pemex (Mexica)- authority shared between the president, legislature, oil ministry, and finance ministry; ONGC (India)- authority shared between the Ministry of Petroleum and Natural Gas as having primary authority, and the parliament and other agencies having subsidiary authority.

market structures within state enterprises have on CNPC alongside its subsidiary, PetroChina; is not as clear-cut. Being that the Chinese government as a one-party state solely run by the Communist Party of China exudes political autonomy and absolute control of its institutions, it courted with liberalisation reforms specifically in its energy sector for the sake of efficiency, thereby creating the somewhat dilemmatic situation of shaking up the political order and completely liberalizing the energy sector. A reality in the mould of the political climate in China is that the heads of China's state-owned enterprises are stewards of the state's political ideology.

Nevertheless, with the introduction of the tenets of corporatization to meet the ends of reforms towards efficiency, the concept of corporate governance has been introduced in CNPC, which sought to shift governance and accountability towards CNPC alongside financing restructuring reforms that gave rise to the listing of PetroChina.[480] Though a subsidiary of CNPC, they operate as separate companies, with CNPC being the financial capital of the enterprise and PetroChina being the operating company. This is not to say CNPC does not engage in operations as it has some technical expertise in particular type of geologies, it is just less efficient – still.[481]

Be that as it may, regardless of whether a state has a unified, shared, hybrid governing mechanisms over their NOCs, or complex as the China case, the doctrine of state attribution would still make the acts of NOCs even those with more powers, attributable

480 CNPC now publishes its own 'Corporate Responsibility' report annually, its own 'Annual Report', as well as it own HSE goals. Thereby, giving CNPC the semblance of a Western corporation.

481 However, due to the element of reasserting of political control over the enterprise, CNPC and PetroChina are not as efficient compared to IOCs. This is telling in a country with about the largest consumption second to the US. And because of this inefficiency, it qualifies as the country with the highest import demand. For a comprehensive evaluation of NOCs in China, see BinBin Jiang, '*China National Petroleum Corporation (CNPC): a balancing act between enterprise and government' in* Victor, D, G., *et al supra* at 379-413

to the state. The doctrine of state attribution has strict application; provided what is proved is that the actor is an entity of the state entity.

4.3.4.6 Constituents of 'Regulation' under the GATT, and implications for NOC's role in International Petroleum Agreements

To establish the presence of regulation by State entities in IPAs is to ask the question, 'what constitutes regulation?' Article XVII (1) (a) and (b) of the GATT are well instructive here. Paragraph (1) (a) requires states acting through their State Trading Enterprises to "act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders".[482] Here, STEs are given the same benchmark as States when it comes to 'regulation'. Where the acts of the STE, as with any other governmental measure, is one that affects imports and exports, it is classified as a 'regulation' akin to government measures. Under paragraph (1) (b), the litmus test for whether a STE's act is a regulation is whether it affects "price, quality, availability, marketability, transportation and other conditions of purchase or sale".[483]

The Panel in *Canada-Administration of the Foreign Investment Review Act* found that for regulation to be established, a government's actions must fall within and conform to the general principles of non-discriminatory treatment prescribed by the General Agreement.[484] In other words, if a government action is one of an international

[482] Article XVII (1) (a) of the GATT.
[483] Article XVII (1) (b) of the GATT. This provision imposes an obligation on States to require their State Trading Enterprises to make their purchases and sales solely in accordance with commercial considerations.
[484] *Canada-Administration of the Foreign Investment Review Act* L/5504, adopted on 7 February 1984, 30S/140, 163, para 5.16. See also *Korea – Various Measures on Beef* where the Panel found that "Article XVII.1 (a) establishes the general obligation on state trading enterprises to undertake their activities in accordance with the GATT principles of non-discrimination. The Panel considers that this general principle of non-discrimination includes at least the provisions of Articles I and III of the GATT." at para 753. In clarifying

commercial character such that it must conform to the GATT principles of national treatment to be internationally acceptable, then that act is a regulation in international law sense. Markedly, STEs are required to conform to the principle of non-discrimination when creating frameworks that affect price, quality, availability, marketability, transportation and other conditions of purchase or sale.

<u>Acts of NOCs constituting 'Measures'</u>

Likewise, to establish the presence of regulation is to establish whether the act of the State Trading Enterprise such as NOCs constitutes 'measures' within the meaning of the GATT. Being that the WTO Agreement is an international agreement signed by national governments and customs territories, the panel defines the term "measures" in the light of Article XXIII:1(b) of the GATT and Article 26.1 of the DSU as referring "*only to policies or actions of governments, not those of private parties*".[485] Articles XXIII:1(b) of the GATT and Article 26.1 of the DSU both refer to the WTO rules on 'nullification and impairment'. Under Article XXIII:1(b) GATT, states may suffer a nullification or impairment of their legitimately expected benefits accrued to them by the GATT as a result of the application of *any measure* by another state whether or not such measures conflicts with the provisions of the Agreement.

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the scope of this obligation, the Appellate Body in *Canada – Wheat Exports and Grain Imports* WT/DS276/AB/R, adopted 30 August 2004, held that "panels must identify the differential treatment alleged to be discriminatory under subparagraph (a) in order to ensure that they are undertaking a proper inquiry under subparagraph (b)"

[485] *Canada-FIRA supra.* Para.10.52

The GATS also lends description to the term 'measure' as to their characteristics. It describes measure as *"…any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form"*. (*Emphasis mine*).[486]

A measure, in any of these forms, even though non-binding can be accorded weight where they can potentially have adverse effect on competitive conditions of market access.[487] According to the Panel, *"[A] government policy or action need not necessarily have a substantially binding or compulsory nature for it to entail a likelihood of compliance by private actors in a way so as to nullify or impair legitimately expected benefits within the purview of Article XXIII:1 (b). It is clear that non-binding actions, which include sufficient incentives or disincentives for private parties to act in a particular manner, can potentially have adverse effects on competitive conditions of market access. For example, a number of non-violation cases have involved subsidies, receipt of which requires only voluntary compliance with eligibility criteria."*[488]

4.3.4.7 The 'Breach of International Obligation 'element

State responsibility has two sides. First, it generally focuses on state responsibility for breach of contract committed by a state entity in its contractual relationship with foreign investors.[489] The other side of state responsibility is not that which arise from breach of a bilateral contract of a state entity, but a breach of an international obligation altogether,

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[486] Article XXVIII (a) of the GATS

[487] Report of the Panel, *Japan – Measures Affecting Consumer Photographic Film and Paper,* WT/DS44/R, 31 March, 1998.

[488] Para 10.49

[489] The principle of State Responsibility emanates from the problems associated with State monopoly powers and the need to protect the investment (property) of foreign investors from acts of States' officials that violate the terms of the contract which are injurious to the financial bottom-line of the foreign investors. See R. Lillich, ed., 'International Law of State Responsibility for Injuries to Aliens' (1983). See also, Feit, Michael, 'Responsibility of the State under international law for breach of contract by a State-Owned Entity' *Berkeley Journal of International Law* (2010) Vol. 28 Issue 1

even though arising from State-NOC-IOC relationships. In general, state breach of a contract entered under a BIT does not as such entail a breach of international law.[490] But that appears to be the general rule. This research argues that to confine state responsibility to violation of State contracts alone is to limit breach only to 'contractual' breach, which goes to undermine the wider coverage envisaged by Article 2 of the ILC Draft Article which envisages state's attribution where a breach constitutes a violation of an international obligation.

An act of a state will constitute a breach of international law when the act does not conform to an obligation, regardless of its origin or character.[491] Cases where a breach of contract would amount to a violation of the state's international obligation brings the breach within the scope of international law. Moreover, it is a principle of international law that a state cannot invoke its municipal law or legislation as a justification to breach its international obligation under a treaty even though the act in pursuance of the municipal law is lawful under domestic law.[492] And for the purpose of Article 4 of the

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[490] See '*Commentaries to the draft articles on Responsibility of States for internationally wrongful acts*' adopted by the ILC as its fifty-third session November, 2001 at 87

[491] Article 12 of the Draft Articles on State Responsibility.

[492] Principle first applied by the PCIJ in *S.S. "Wimbledon Case"*, 1923, P.C.I.J., Series A, No. 1. See also, *Greco-Bulgarian Communities*, 1930, P.C.I.J., Series B, No. 17, at p. 32; *Free Zones of Upper Savoy and the District of Gex*, 1930, P.C.I.J., Series A, No. 24, at p. 12; *Free Zones of Upper Savoy and the District of Gex*, 1932, P.C.I.J., Series A/B, No. 46, p. 96, at p. 167; *Treatment of Polish Nationals*, 1932, P.C.I.J., Series A/B, No. 44, p. 4, at p. 24; *Jurisdiction of the Courts of Danzig*, 1928, P.C.I.J., Series B, No. 15, at pp. 26-27. See also, the International Court's application of the principle in See Fisheries, I.C.J. Reports 1951, p. 116, at p. 132; *Nottebohm, Preliminary Objection*, I.C.J. Reports 1953, p. 111, at p. 123; *Application of the Convention of 1902 Governing the Guardianship of Infants*, I.C.J. Reports 1958, p. 55, at p. 67; *Applicability of the Obligation to Arbitrate under Section 21 of the United Nations Headquarters Agreement of 26 June 1947*, I.C.J. Reports 1988, p. 12, at pp. 34-35, para. 57. See also, Article 27 of the Vienna convention on the Law of Treaties, 1969. In the *Reparations Case,* the ICJ noted that "[a]s the claim is based on the breach of an international obligation on the part of the Member held responsible… the Member cannot contend that this obligation is governed by municipal law". See *Reparation for Injuries Suffered in the Service of the United Nations*, I.C.J. Reports 1949, p. 174, at p. 180. The ICJ made this distinction between an act being lawful under municipal law but a breach of a treaty in *the ELSI* case where is stated thus: "Compliance with municipal law and compliance with the provisions of a treaty are different questions. What is a breach of treaty may be lawful in the municipal law and what is unlawful in the municipal law may be wholly innocent of violation of a treaty provision? See *Elettronica Sicula S.P.A.* (ELSI), I.C.J. Reports 1989, p. 15

Draft Article on State Responsibility, the entry into or breach of contract by a state organ is nevertheless regarded as an act of state.[493] However, it is important that for such contractual act of the state entity to be constitute the state's breach of international obligation, it must be that which concerns governmental activities rather than merely other private or commercial activity.

4.3.4.8 Acts of NOCs constituting State's breach of international obligation'

State-NOC-IOC contractual relationship does have bearing on the States' international obligation and in this case – obligations under the WTO. And a discussion on that connection between state responsibility for acts of NOCs in IPAs and breach of state's international obligation becomes imperative, especially as it will help determine the extent to which the doctrine of attribution and state responsibility for an international wrongful act may or may not be relevant to trade-related issues.

We have addressed the question of what acts of NOCs are commercial or regulatory to infer state liability for violation of its international obligation arising therefrom. The connection can be made from three points. First, that the act of drafting or collaborating in the drafting of a framework that leads to the construction of IPAs qualify as regulation- hence, designated state measures. Secondly, that the implementation and administration of the terms of the agreements by NOCs as state-controlled entity (or State Trading Enterprises) are actually attributable to the state for the purpose of violation of Article III:4 of the GATT. This leaves us with the question of whether the

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[493] *Swedish Engine Drivers' Union Case*, E.C.H.R., Series A, No. 20 (1976), at p. 14; and *Schmidt and Dahlstrom*, E.C.H.R., Series A, No. 21 (1976), at p. 15.

outcome of the terms of International Petroleum Agreements do have effect on export of oil and gas (i.e., trade effects) to qualify as the state's violation of it WTO obligation.[494]

We bear in mind that the cardinal principle behind competition is non-discrimination against investors which is the crux of both the National Treatment principle and the Most Favoured Nation principle. Following the transition from state monopoly to competition, protection of foreign investors' property and compensation was no longer the only goal of the principle of state responsibility but also the protection of investors' economic interest from unfavourable discriminatory conditions in foreign markets so that they are able to compete in foreign markets with domestic investors as is befitting of a privatised or deregulated market with competition values.[495]

But the aim of the attribution question enshrined in Article 2 of the ILC Articles on State Responsibility is generally to determine whether even within investment contracts such as IPAs, there is the presence of an act of state which constitutes measures that are capable of bringing the state in violation of an international obligation. The weight of such measures such that they gain the attention of international law is evident when they contravene obligations that especially arise from customary law, treaties, and/or general principles of international law.[496] The implication of this would be that where such

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[494] *Trade effects* of IPAs here refers to any impact on export volume. However, this is distinguished from IPAs having *trade elements* such as trade clauses within them or even a stand-alone trade agreements such as *Purchasing Agreements* and *Gas Sales Agreements.*

[495] N. Anthill and R. Arnaud, Oil & Gas Equities: Evaluation and Trading (1994); E. Penrose, G. Gaffe, and P. Stevens, 'Nationalisation of Foreign-Owned Property for a Public Purpose: An Economic Perspective on Appropriate Compensation', 55 MLR (1992) p. 351;

[496] See Crawford, J., *The International Law Commission's Articles on State Responsibility,* (Cambridge University Press, 2002) at 81 for an extensive elaboration of the 'objective' nature of element of breach of treaties, customary law, and general principles of international law; *Yearbook of the ILC* 1973, vol. II, p.179.

measures, even though lawful under national law (or systemic under specific treaties), have elements that would constitute an international wrongful act of the state due to its WTO-inconsistency – the WTO being an international treaty, then such measures are to be governed by international law.[497] These are the issues which makes the WTO relevant to the way business is done in the international oil sector.

Where a state directly or through a state entity implement acts that violate the national treatment principle, they are not just a commercial relationship but also in breach of their international obligation under the WTO, and where applicable, the ECT. The violation of the national treatment is that element that creates the linkages between commercial aspect of the doctrine of state attribution and international law, since the non-discrimination principle is a prominent principle in international economic law.

4.3.4.9 Implication of the Attribution Doctrine for the WTO

On the heel of these analyses, in the event of disputes arising from host States' breach of the terms of competition (i.e., national treatment and most favoured nation principles) either directly or through the channels of their NOCs in the form of discriminatory acreage allocation; local content requirements; expropriation; and/or ordering divestment in ownership interest, the case has been made here that international law should apply. An extended question however is whether its application should be within the confines of international investment law, or should likewise extend to obligations under international trade law on the grounds that these measures constitute TRIMs which is within WTO scope.

[497] Article 3 of the ILC Articles on State Responsibility. See also, Article 3 (b) and (c) of the VCLT

It has been observed that in these instances, international investment law instruments such as BITs, as well as investment treaties such as NAFTA and ECT is the appropriate law that should govern this principle of State responsibility for violation of commercial obligations, rather than trade law; and their Dispute Settlement mechanisms rather than the WTO Dispute Settlement Body.[498] In fact, even though the GATT has a 'national treatment' provision in Article III GATT, it has been suggested that the meaning of non-discrimination in trade law terms should be distinguished from non-discrimination in investment law terms.[499]

But since the *raison d'etre* for the State Responsibility doctrine also extended to the protection of foreign interests against acts of States that contravene the principles of competition set out in the WTO law, the doctrine should also extend to violation of international trade obligation and not just contractual obligation.

4.4 **Conclusion**

This chapter has provided a compendium of border measures and trade-related investment measures specific to the oil sector and their relationships and implications for the WTO regime. Apparently, oil producing States' border measures affecting export volume and their behind the border (i.e., when internal legislations affects investors investment in the production of oil) does pose the question of competence for the multilateral trading regime. It then provides a prognosis for trade dispute that could

[498] Walde, T., *State Responsibility for subnational authorities and non-state national entities'*, 27 Netherlands Yearbook of International Law (1996) at 150

[499] *Ibid.* The thinking generally is that because that breach arising from State/non-State actor relationship is a matter of breach of contract rather than breach of international law, the doctrine of State Responsibility for international wrongful act is governed by investment law and not trade law.

arise from these measures in the event that disputes arise in these areas in the future. We see that while the border measures focus on the relationship between the WTO and OPEC as an exclusive treaty in relation to production restriction, the TRIMs focuses on the relationship between the WTO and national governments as sovereign States. The dynamics of both terrains are problematic for the WTO because of the normative force behind domestic management of crude oil, which is commonplace in the industry. The question of their negative effect on international trade is however, both a policy and a legal question. From the policy perspective, acts of OPEC or acts of national regimes are sacrosanct, but from the legal perspective, the primacy of WTO law as a supranational regime must contend with policy realities arising from economic interests.

5

Gas Sector Regulatory Measures and the Trade Effects question

5.1 Introduction

> *"Compared with oil reserves, the world's natural gas reserves are even more concentrated in just a handful of countries. Russia, Iran, and Qatar hold the bulk of the world's conventional natural gas. What sets the gas business apart from the oil business is that gas trade is predominantly structured on a regional basis because of the need for pipelines to deliver gas. This explains the growing role of natural gas in world energy trade."*
>
> Thijs Van De Graaf [500]

In the absence of an institutional forum for gas exporting countries akin to OPEC, we would have expected a smooth sailing for the WTO in governing the gas sector. But the nature of gas and the network structures in gas trade guarantees even a sterner terrain for the WTO. Chapter four has addressed the extent to which direct border measures and trade-related investment measures (TRIMs) in oil is complex for the WTO in spite of its applicability. Border measures and TRIMs in the natural gas sector is even more complex for the WTO. Even though gas is without question classified as 'goods' within the GATT meaning,[501] to view international trade and TRIMS in gas through the GATT/WTO lens would be somewhat audacious for obvious reasons.

The type of restrictive business practices envisaged by the WTO/GATT such as quantitative (or production) restrictions, subsidies to domestic suppliers or technical requirements are not as commonplace in the gas sector. Again, while the GATT governs

[500] Thijs Van De Graaf, *The Politics and Institutions of Global Energy Governance* (London, Palgrave Macmillan, 2013,) at 73.

[501] Article 11 (1) of the Draft Consolidated Negotiating Text of the Doha Negotiations on Trade Facilitations suggests that 'goods' in the definition of 'traffic in transit' under Article V of the GATT as well as the Agreement on Trade Facilitation covers the movement of goods via pipeline. See also WTO Secretariat, '*Negotiating Group on Trade Facilitation – Draft Consolidated Negotiating Text*' (21 April, 2011) TN/TF/W/165/Rev.8, at 21

state actions, competition in the gas market has warranted the prominent role of private entities in gas trade across the value chain from production to distribution. By this, the WTO will have to grapple with dealing with acts of private entities (non-State actors), which are not State-owned as is the case of NOCs, but yet have implications for international gas trade. Besides these simplistic explanations, there are underlying reasons for the seemingly unconventional relationship between international trade law and the natural gas regime and these reasons can be found in the physical characteristics, market dynamics, and regulatory design of natural gas.

While every other good, including oil which can be stored in barrels, can be traded from producing country to any part of the world, for economic reasons natural gas cannot be easily stored, packaged, and traded across the globe. Although gas storage is now made possible through reinjection storage facilities, storage is hardly practicable due to its capital intensive cost and the uncertainties that surround the physical characteristics of the storage facilities.[502] And since a huge percentage of produced gas are associated gas, which are in most cases an unintended outcome from oil production,[503] they are likely produced without a gas sales contract and a ready buyer (non-contracted gas), especially a seller's nomination contract that would normally ensure revenue stream for the seller.

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[502] Storage of gas for redelivery at high demand seasons involves building storage facilities such as storage underground by a depleted gas reserve facility, injecting gas in a porous permeable rock formations (aquifers), salt dome deposits facility (salt caverns), and linepack, which all drives sunk cost even higher. Can also be stored by liquefaction. Also, prior to storage, the impurities in gas content including methane, ethane, propane, butane, and pentane must be treated. For percentage of impurity contents in natural gas, see IEA '*Natural Gas Transportation: Organisation and Regulation*' 1994 at 32. However, the geological and physical characteristics of aquifer reservoir are too uncertain to arrive at a credible evaluation as to its suitability for gas storage, thereby requiring significant investment just for investigation alone. Salt caverns are not usually massive and so cannot store high volume of gas for a long-term requirements, yet they are more expensive to develop. The industry is not experienced with offshore gas storage facility.

[503] However, due to improved technologies, there are cases like in China where the major oilfields such as Daqing and Shengi which have used associated gas for oilfield fuel and to heat their heavy crude streams for long distance transport. And as such, in the 1990s as oil production peaked, natural gas output stagnated. See Fridley David, *'Natural Gas in China' in* Stern, J., (ed) *Natural Gas in Asia: The Challenges of Growth in China, India, Japan, and Korea* (Oxford University Press, oxford, 2nd ed, 2008) at 14

In the absence of storage facilities, getting rid of non-contracted associated gas as quickly as possible is a challenge. The easier option is to flare it.[504] But there is the environmental consequence and the bad press that accompanies flaring.

Trading gas in the spot market follows as a meaningful and flexible alternative. Spot gas however is not necessarily a dependable alternative. Even gas available for spot markets do face the reality of seasonal demand ("swings") for natural gas leading to stranded gas already produced. To balance the supply load with demand "swings", significant investment must be injected into building production and transmission storage infrastructures, thereby bringing us back to the issue of storage discussed above.

The other option is to store and ship gas via LNG. But landlocked producing States must invest in gas gathering pipelines to move gas from production point to coastal liquefaction terminals and this requires huge capital cost enough to designate investments in gas gathering pipelines as 'sunk costs'. Even for coastal producing States, liquefaction and regasification terminals are massive capital projects that can take up to two to three decades to recoup.[505] This, again, plays into LNG costs.[506]

On the heel of all the above scenarios, the most practical option has always been to build pipeline networks linking production point to regional markets.[507] Figure 1 shows the

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[504] As at 2012, world associated gas flared annually were equivalent of about 25 per cent of the annual natural gas consumption in the United States or about 30 *per cent* of the annual gas consumption in the European Union. See *Global Gas Flaring Reduction Partnership* (GCFR), World Bank, October 2011.

[505] Giorgio Bresciani, Dieuwert Inia, and Peter Lambert, '*Capturing Value in Global Gas: Prepare now for an uncertain future*' (McKinsay on Oil & Gas, April, 2014) at 7

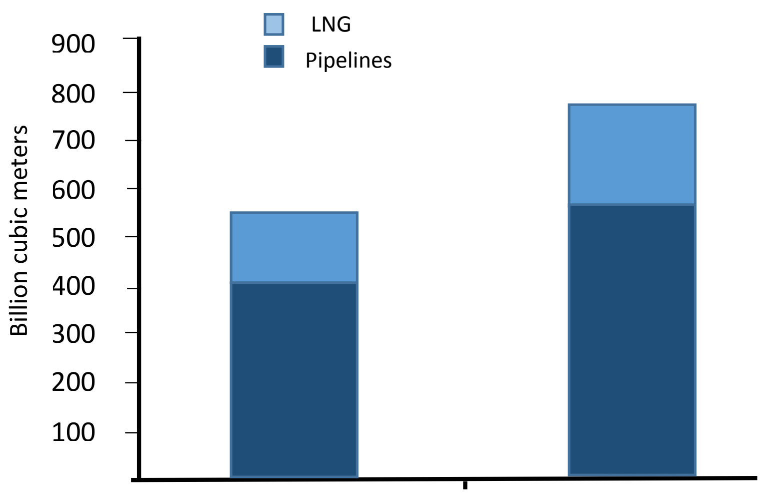
[506] LNG from North America is noticeably very expensive; high LNG projects costs in Australia and Russia mean that they depend on Asian LNG price to remain high in other to be commercially viable; while LNG producers in East Africa mostly require buyers to commit to long term LNG contracts that are linked to high oil price before committing to new LNG projects. There are arguments that over the years, LNG tend to get cheaper. A recent report by the Gas Technology Institute shows that the cost of LNG production has dropped by 50%. See *Ibid* at 5.

[507] Gas networks include both simple connection of two points from exporter to importer to several supply points along distributions routes, and the fully integrated pipeline networks within regional markets. An

ratio between gas trade via pipeline and via LNG between 2001 and 2007. Pipelines however are another beast shrouded in complexities. But before going into the intricacies of pipeline gas trade, it is important to mention briefly about LNG export restrictions.

Figure 1: International gas trade by transport mode,

2001 and 2007



Source: BP Statistical Review of World Energy 2008

5.1.1 *LNG export restrictions in the context of international trade*

Without question, LNG is increasingly seen to be the game changer that will inspire a global gas market.[508] Although the US has recently lifted its policy on oil export ban, we note that the US still maintains LNG export restriction to countries outside the North American Free Trade Agreement (NAFTA). Analysts have rightfully noted that restricting LNG export as a covered good to the exclusion of other WTO member states

example of the former is import pipelines from Russia into Europe which is then transmitted from receiving terminals to markets via local routes. An example of the latter is the EU single market pipeline network governed by the energy charter treaty. These network structures ensure that the construction of competing networks and distribution systems in the gas sector is on a regional or bilateral level.

[508] Thijs Van De Graaf, *supra* n. 1

amounts to a violation of Article XI:1 of the GATT.[509] And since this policy has been long-standing, any defence under Article XI: 2(a) GATT which allows states to apply restrictions "temporarily" to relieve critical shortages of a product, stands to be defeated.[510]

Article 1 of the GATT on the 'Most Favoured Nation Principle' also comes to mind. However, since Article 1 of the GATT is with respect to non-discrimination through granting favour or making concessions in customs duties and charges of any kind favour of some States, rather than a ban in export to some countries, it is unclear whether it applies to policies exporting goods only to some States in a free trade area in line pursuant to Article XXIV of the GATT, as is the case with the US LNG export policy.

That said, Paragraph 4 of Article XXIV provides that "the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories". Since the US LNG export restriction policy does exactly that, it points to a violation of the tenets of para 4 of Article XXVI of the GATT. As important as LNG is to international gas trade, LNG will not be central to the discussion under this chapter because firstly, it is less complex in terms of regulation and secondly, except the liquefaction and regasification terminals, LNG's characteristics as trade in commodity via tankers are

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[509] See Spiegal-Feld, Danielle, "In the LNG Export Debate, the WTO can't be ignore" Breaking Energy, June 23, 2014. Available at http://breakingenergy.com/2014/06/23/in-the-lng-export-debate-the-wto-cant-be-ignored/ (Last visited May 1, 2015). See also Gary Clyde Hufbauer, Allie Bagnall, and Julia Muir, "LNG Exports: An Opportunity for America" Peterson Institute for International Economics, RealTime Economic Issues Watch, January 24, 2013. This report was submitted to the US Department of Energy on January 22, 2013. Available at http://blogs.piie.com/realtime/?p=3315 (Last visited May 1, 2015); See also, Cathleen Cimino and Gary Clyde Hufbauer, "US Policies toward Liquefied Natural Gas and Oil Exports: An Update" Peterson Institute for International Economics, Policy Brief, July 2014.
[510] Gary Clyde Hufbauer, *et al*, "LNG Exports: An Opportunity for America" *ibid.*

similar to that of oil and so are covered by the discussions on oil. Now we discuss the more complex situation with pipeline gas.

5.1.2 *Interstate, transit pipelines, and spot gas in the context of international trade*

Unlike LNG and oil pipelines where the players are mostly States or national gas companies and national oil companies respectively, investment and transmission of gas via pipeline involves mainly private/non State-owned entities. Also, unlike oil pipelines which connects parts of the same industry and so is owned by consortium of oil companies as one project, gas pipelines connect different industries, for instance, gas transmission pipeline company separate from the gas distribution company, and so is regarded as a public utility.[511] The intrigues surrounding gas pipelines is more complex.

Nonetheless, what makes the gas pipeline option the most viable for gas trade is the proximity between production point and the city gate, and proximity has a different outcome on gas pricing. Regional networks tend to favour gas pricing since pipelines can only cover so much distance. Due to economies of scale inherent in pipelines, investment in building pipeline infrastructure was only viable where the network entities are natural monopolies.[512] This means that supplies are more efficient with one firm better poised to own volume risks associated with both pipeline capacity and

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[511] OECD Special Committee for Oil, 'Pipelines in the United States and Europe and their legal and regulatory aspects' OECD 1969. p. 3-4. However, it is commonplace that a company can be involved in production and transmission. Author also highlights this in page 25.

[512] For a general discussion on pipelines as natural monopolies, see Stevens, P., "*A History of Transit Pipelines in the Middle East: Lessons for the future*", University of Dundee, CEPMLP seminar paper sp23, 1996. See also, Arthur S. De Vany and Walls., *The Emerging New Order in Natural Gas: Markets versus Regulation* (greenwood publishing group, United States, 1995). According to the author, pipelines being natural monopolies are due to underlying core beliefs "that there are economies of scale in pipeline size and output, that duplicating pipelines would be wasteful" at 15. For factors that influence the high capital cost of pipelines, see Omonbude, E.J., *Cross-border Oil and Gas Pipelines and the Role of the Transit Country: Economics, Challenges, and Solutions* (England, Palgrave Macmilian, 2013) p. 13

pipeline commodity as will be seen later. Traditionally, pipelines are still natural monopolies today. With the breaking up of the vertical integration structure that now ensures market entry for both large and small independent players, pipeline networks are now fragmented - consisting of; producers, pipeline companies, shippers, marketers, and local distribution companies. As a result, gas trade is usually facilitated on the basis of bilateral transactions between players within the chain.

On the positive note, there is a link between open access pipelines and affordable price at the city gate.[513] For instance, in *United States v. El Paso Natural Gas Coy,*[514] the presence of PNW, a new entrant into the supply market in California which was dominated by *El Paso,* eventually forced *El Paso* to reduce its selling price by 25 percent. *El Paso's* subsequent agreement to acquire PNW was held by the Court to be in bad faith aimed at stifling competition and maintaining its dominant position. This case is analysed in more detail under the discussion on abuse of dominant position. In the European single market, the two cardinal goals of competition policy are: better services at reduced prices for consumers and the promotion of economic integration within the internal market through employment.[515] Liberalization however does come with its own challenges especially in the European single gas markets.

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[513] Arthur S. De Vany *et al, ibid*. The authors stated instructively thus, "*Open access pipeline transportation and partial bypass at the city gate have been brought at most, but not all, city gates in line with prices in the fields. It is not the distance alone that makes the difference, for very distant market centres are highly integrated with production fields and their prices track one another closely*." At p. 11.

[514] 376 U.S (1968) 84 S.Ct. 1044, 12 L.Ed.2d 12

[515] Karel Van Miert, 'Liberalization of the economy of the European Union: the game is not (yet) over'. An introductory speech presented at the conference on 'competition, liberalization, and state monopolies' held in liege, November 1998, and printed in Damien, G., (ed) *The Liberalization of State Monopolies in the European Union and Beyond* (Kluwer law international, the Hague, London, Boston, 2000) at p.2.

Besides there are regulatory issues with entry; uncertainty as to ownership in a chain of pipelines within the single energy market; uncertainty over the destination for non-contracted gas; and the transit bottlenecks with transit pipelines straddling countries with different economic and political landscapes; and the technical issues with pipelines (e.g., throughput capacity and quality specifications).

The relevance of gas trade in the WTO context can be tackled from two angles. The first part relates to how a balance between regulation of the single gas market as in the EU internal single market and under regulated market entry impacts on availability of gas commodity across the value chain from production, generation, transmission, and distribution of commodity to end users.[516] This invokes trade-related investment measures (TRIMs) element into the discourse. The second part deals with transit issues between sovereign States. i.e., bulk transfers of gas from exporting to importing country through transit countries both off-taker transit country or purely transit country. This invokes the GATT rules vis-à-vis the ECT on transit.

The objective of this chapter is therefore two-fold. First, it aims to ascertain those regulatory measures in mainstream gas markets and the unregulated spot markets (i.e., the capacity and commodity markets) that both shape the international gas market, the extent to which each have trade effects, and whether the trade effects are sufficient to justify interpretation of breach under the WTO rules in the future. Secondly, it asks

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[516] See European Union Committee, *'Gas: Liberalised market and security of supply'* 17th Report of Session 2004-2004. Liberalization of the context of the gas market entails the legislative process that facilitates ownership, control, access to, and use of gas transmission, distribution infrastructure (pipelines), and storage such as line packs by competitors having shared access to monopoly infrastructure that enables them to compete. See European Union Committee, *'Gas: Liberalised market and security of supply'* 17th Report of Session 2004-2004

whether the WTO rules can guide or facilitate better trade outcomes for non-contracted gas on the spot market.

5.1.3 *Why the European Single Market?*

Although Russia, Iran and Qatar account for the bulk of the world's conventional natural gas production, this chapter mainly focuses on regulation from the stand point of the European single market rather than the Asian, Middle East or American market because Europe stands out as the core destination for most pipeline gas from outside the internal market. Also, the European single market is a model structure for gas trade for its acclaimed transparency and continuous evolution.

As for Asia, in the four countries with the largest markets for primary energy demand namely: China, India, Japan, and Korea, gas use is relatively low in their energy demand mix with slight increase in Korea's gas demand. Meanwhile, the majority of Asia's gas import is via LNG.[517] In the Middle East and North Africa (MENA), gas export is likewise largely via LNG, accounting for up to 40 percent of global LNG export as at 2008.[518] Nonetheless, trade in gas via pipeline is prominent in MENA with cases of export restriction due to a large extent the rise in domestic demand amongst many MENA countries.[519] As for Russian gas to Europe, restrictions are mainly about political

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[517] Stern, J.P., (ed) *Natural Gas in Asia: The Challenges of Growth in China, India, Japan, and Korea* (England Oxford, Oxford University Press, 2008). Stern noted that while other Asian countries such as Malaysia, Bangladesh, Indonesia, Pakistan, Thailand, and Taiwan have relatively more significant and rapid growth in gas demand, their markets are not as large as the other four.

[518] Fattouh B., and Stern, J.P., (eds) *Natural Gas Markets in the Middle East and North Africa* (England Oxford, Oxford University Press, 2011) at 9

[519] For instance, Saudi Arabia which has the fifth largest natural gas reserve in the world, limits its gas production which is mainly associated gas, and has an export restriction on natural gas produced to meet local consumption. See '*Saudi Arabia*', EIA report, September 10, 2014 at page 14. Http://www.eia.gov/countries/cab.cfm?fips=sa. However, in countries such as Iran and Iraq, export constraints arising from political and economic factors rather than export restrictions arising from policy regulation are rife. See Bassam F., and Jonathan P. Stern, *ibid*

relationships, thereby falling within the discourse on transit as it pertains to both the EU-Russia Gas Transit Control Protocol and Russia's short-lived ratification of the ECT.[520] Bearing this in mind, since the WTO makes provision for transit- albeit in much less details than the ECT as shown in chapter three, this section will gloss over transit issues arising from bottlenecks surrounding gas entry into the European market.[521]

The development of the single gas market in Europe, its surrounding complexities, and the transit bureaucracies of natural gas from outside the region into the internal gas market have also triggered calls for the development of an international gas market by trade scholars.[522] Such proposals have also been recorded as an agenda of the UN General Assembly.[523] But what would such a proposal for an 'international' gas market mean for the WTO? Will the trade implications of an international gas market, with competition playing a major role, eventually justify gas trade falling within the WTO scope?

5.2 <u>The 'Trade Effect' question</u>

In spite of the incongruous relationship between international gas trade and the WTO/GATT, border measures and TRIMs in the gas sector, especially in the internal gas

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520 The EU Russia Gas Transit Control Protocol would require Russia to facilitate gas trade to European markets without discrimination as to destination or origin. For literatures on the Protocol, see Aolto, P., (ed) *EU-Russian Energy Dialogue: Europe's future energy security* (England, Ashgate Publishing, 2008); '*Pipelines, Politics, and Power: The future of EU-Russia energy relations*' Centre for European Reform (October, 2008); Konoplyanik, A., '*Russia- EU, G-8, ECT and Transit Protocol*' RUSSIAN/CIS Energy & Mining Law Journal, 2006, Vol IV.

521 For instance, most of North African gas exports such as from Algeria and Egypt are bound for the European markets due to their close proximity. But in Algeria for instance, besides it subdued upstream gas development, domestic consumption of natural for fuel its power generation has shaped Algeria's gas supply and export policy balance. Fattouh., Stern,J.P., *supra* n at 43

522 See Andrei, A., Konoplyanik, 'Energy security and the development of international energy markets', *in* Barton Barry *et al.* (eds), *Energy Security: Managing risk in a dynamic legal and regulatory environment* (Oxford: Oxford University Press, 2004) 47, at 52, 57; Kim Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law (*the Netherlands: Kluwer law international, 2011) at 11.

523 United Nations General Assembly (U.N GA) resolution 63/210 of 3 February 2009.

market, is essentially about access to networks (market access issues), and the GATT/WTO is mainly 'market access' focused. This alone is a link we can start from. The challenge arises with ascertaining the incongruous nature of that link between the trade dynamics of natural gas and the underlying tenets of the GATT rules applicable to energy.

Tackling the question of the 'trade effects' of regulatory measures in the gas sector is to establish whether measures affecting access to and investment in networks have implications for both pipeline capacity and gas commodity volume; and whether this essentially constitutes TRIMs or border measures respectively in WTO terms. The 'trade effect' question also extends to establishing whether a breach in the terms and conditions for trade in non-contracted gas at the spot market have any implications for international gas trade enough to apply trading rules under the GATT. The findings will go to either justify or refute the relevance and application of the WTO rules in the natural gas sector. But whether a trade effect *simpliciter* is sufficient to invoke the WTO's competence is another matter.

Generally speaking, it should be noted that the GATT rules can only come in at the point where international trade in gas actually takes place, and that is at the transmission line of the gas chain, whichever point is agreed by a gas sales contract.[524] Once gas arrives at the transmission point from the gas gathering pipeline, it is deemed destined for export to the territory of another country. Gas before that stage is not of tradable value.[525] Hence

[524] Transmission may be either at the interstate border or at the seller's facility where gas is still at the seller's possession.

[525] Due to the hydrocarbon corrosive contents of natural gas, which is not suitable for transportation to markets via pipeline, the concern for producer is to transport untreated gas from the production field to the transmission line. At this stage the effort is on investment in gas gathering pipeline to achieve that. For a detailed explanation of the physical components of gas, and transportation and treatment of untreated

regulation of new entrants' access to transmission can be likened to regulation that can influence investment decisions of network, and where such decisions have outcome on gas volume, it 'may' qualify as trade-related investment measure. Maybe not particularly in the WTO sense, but it initiates the 'trade effect' question nonetheless.

Three 'trade effect' scenarios will be examined. The first two will be examined more closely than the third. First scenario relates to regulation. It is where regulation constrains (not prohibit) access. This is a situation whereby regulatory authorities may refuse prospective entrants entry into pipeline networks (The issue of capacity). Establishing the trade effect from this scenario is hinged on a clear assessment of whether the regulatory intervention through refusal of entry is justified, and what impact the refusal does have on pipeline capacity, on transmission, on volume at the city gate, and ultimately its ripple effect on commodity to end-users downstream.

Second scenario is where liberalization itself opens up the field to volume risks. This is a situation whereby small entrants without the capacity to manage volume risk are allowed access to markets in such a way that disrupts or hinders long term contracts that would normally ensure security of supply. Spot markets will be discussed under this heading too. On these two scenarios, the balancing act between the ease of access to transmission lines and the regulation of access to ensure efficient competition becomes imperative.[526] The third scenario is related to resource access. It is whereby measures by

newly extracted gas with throughput quality with gas gathering pipelines, see EIA report, September 10, 2014 at 31.

[526] Piet Jan slot, '*Energy (Electricity and Natural Gas), in* Geradin Damien (ed) *The liberalization of state monopolies in the European union and beyond,* (Kluwer law international, the Hague, London, Boston, 2000) at 51.

either an exporting country outside the internal market into the internal market, or measures by both transit States constrain the flow of or restrict the export of gas.[527]

5.3 Competition in Gas Market and implication for International Gas Trade.

The regulation of access to investment in transmission is crucial because competition cannot thrive without some form of regulation or State measures to facilitate it.[528] By regulating the entry into the natural gas value chain, States begin to tread the national treatment terrain. And the national treatment principle, which embodies the tenets of competition, is a trite obligation under Article III of the GATT.[529] It should be noted however, that liberalization and competition in the internal energy market is not the same as liberalization and competition in the WTO sense. The objective of the European Community Regulatory Authority (ECRA) policy is to create a European single market whereby Member States adhere to the tenets of competition in the facilitation of trade in goods and services within the community.

WTO law on the other hand does not perceive competition and liberalization in this light. In WTO law parlance they relate to the promotion of international trade in goods through substantial reduction of tariffs and removal of other trade barriers implemented

[527] Transit challenges can involve mainly: the off-taking countries taking more than is allowable, pure transit countries imposing outrageous transit fees, or exporting countries simply restricting export.

[528] Liberalization in gas systems does not necessarily strip the state of regulation entirely. States simply diminish their regulatory autonomy which they had exercised in a vertically integrated structure, and instead- through the process of unbundling, create the environment where activities within the segments of the value chain are driven by market forces.

[529] The US state regulation of reflects such instances of state regulation of competition whereby the natural gas act of 1964 states thus "*a certificate shall be issued to any qualified applicant…if it is found that the applicant is able and willing properly to…perform the service proposed…and that the proposed service…is or will be required by the present or future public convenience and necessity…*" and the it goes further to state "*nothing contained in this section shall be construed as a limitation upon the power of the commission to grant certificates of public convenience and necessity for service of an area already being served by another natural gas company*". See U.S. Code 717 f (g) , 1964

within national boundaries of WTO Member States through the elimination of discriminatory measures.[530] The core difference being that the WTO does not seek to create a uniform world market. This distinction is crucial putting in context the relevance, authority, and competence of the WTO in natural gas trade. In this vein, the nature of the European single energy market may have to be weighed against the WTO rules relevant to natural gas. On this note, it is therefore apt to state that the first step to examining market access in the gas sector and its relevance to the WTO rules is to understand the nature of natural gas pipeline markets. I hereby approach market access in the gas sector from the lens of two markets. The *Pipeline Capacity Market* and the *Commodity Supply Market*.[531]

5.4 Volume Risks in Pipeline Market and Commodity Supply Market, and their effects on international gas trade.

5.4.1 *Gas Commodity Market and Implications on Volume*

Gas commodity is the physical units of gas available for end use downstream. A commodity contract is the contract to sell and buy units of gas under certain terms and conditions relating to price, delivery, and quality of the gas; mainly through a Natural Gas Futures. Natural gas futures simply ensure spot gas is delivered at predetermined future dates usually within consecutive months, at a fixed price regardless of decrease or increase in market price, and which is paid consistently throughout the life of the contract. This arrangement is designed to lock the price as a way of managing price risk,[532] but very significantly, it ultimately secures delivery of commodity to markets. In

[530] See paragraph 3 of the Preamble to the Marrakesh Agreement Establishing the World Trade Organisation.
[531] See Omonbude, E.J., *supra* n 512 at 20. The author identifies these two markets and nothing more.
[532] However, since futures can backfire for the producers in the event of increased market price during the course of the contract period or backfire for the seller (e.g., power company) in the event of decreased market price, they could to opt for futures with a short hedge life span, which can be renewed upon expiration.

essence, gas commodity contract has the dual importance of protecting parties from price risk and allocating volume risk to parties who feel secure under prevailing price conditions to ensure that volume is not jeopardised due to financial constraints.

Apart from natural gas futures, the spot market uses other trading instruments to facilitate trade in gas commodity. [533] They include: the forward contract,[534] hedging,[535] options contract,[536] exchange of futures for physicals (EFP) contract,[537] and the alternative delivery procedure.[538] We can see that all these contractual tools available to parties embody the spot market. Since spot gas normally arises from the imbalances between demand and supply – that is, production in excess of demand, especially during low swings, spot market is essentially about finding the right price at which a buyer is willing to commit payment for the gas. And since spot market is not particularly regulated, but is rather on the basis of bilateral negotiation between non-State private entities, then there is no case for breach of any WTO provisions. Breach is therefore contractual breach rather than treaty breach.

Hence, forecasting is crucial to negotiating futures. See Options House, '*Natural Gas Futures Trading Basics*' for a detailed illustration of hedging. Available at: http://www.theoptionsguide.com/natural-gas-futures.aspx (Last visited April, 18, 2015)

533 Juris Andrej '*Development of Natural Gas and Pipeline Capacity Markets in the United States*' (2008) Policy Research Working paper, World Bank, Private Sector Development Department, Washington, DC. at 22-24

534 Similar to the futures, but unlike the futures requires payment in full either at the time of the delivery or after delivery.

535 Hedging either makes a futures contract long (long hedge) or short (short hedge) so as to mitigate loss that could be incurred from futures in the event of either increase or fall in price in the future

536 Options contract gives a party the right to sell or purchase a futures contract for a specified price and within a specified period in exchange for a one-time premium payment.

537 Is a futures contract that sets a separate delivery point and/or deviate from the price from those specified in an already existing futures contract aimed at mitigating execution risks and bringing flexibility to supply conditions.

538 This takes place upon termination of the trading at the end of the last delivery in the futures contract, and whereby the parties may agree that buyer takes delivery under different terms and conditions from the standardized contract.

5.4.2 *Pipeline Capacity Markets and Implications on Volume*

Gas pipeline capacity on the other hand is the physical dimension or size of a pipeline designed to accommodate an optimal utilization of the pipeline. It is expressed as volume per unit length (bbl/ft). Pipeline capacity is crucial for striking a balance between demand and supply of natural gas. Therefore, a discrepancy in capacity could have implications for volume. The fluid volume of pipeline capacity is determined by boundary pressure both at inlet and outlet, flow characteristics, ground elevation, density and delivery pressure.[539] All of the above means investment in pipelines must cater for the capacity market, and this projection is crucial to international trade in gas. A pipeline company with low capacity seeking to increase its volume per unit length to meet increased demand will require investments in capacity upgrade.[540] This option can be referred to as "cheap incremental capacity".[541]

A capacity contract is usually entered between the producer or shipper (owners of the gas) and the pipeline company (transporter of the gas) whereby the shipper books certain capacity to transport its gas to markets while the pipeline company invests in pipeline infrastructure to meet capacity bookings. A pipeline company failing to meet the booked capacities would result in less quantity of gas per unit length with knock-on effect for gas volume downstream. In terms of breach, it risks the producer and shipper

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[539] Gassco, operator of the world's largest sub-sea transportation system for natural gas defines capacity in different nomenclatures in terms of their measurements and functions such as *hydraulic capacity*, *Available Technical Capacity*, and *committable capacity.* See Leif Idar Langelandsvik *et al*, '*Accurate Calculation of Pipeline Transport Capacity*'. See also Schlumberger at http://www.glossary.oilfield.slb.com/en/Terms.aspx?LookIn=term%20name&filter=pipeline%20capacity

[540] Oil & Gas Journal, May, 2010 , "*WBI to expand Bakken natural gas pipeline capaci*ty". Available at http://www.ogj.com/articles/2010/05/wbi-to-expand-bakken.html (Last visited 12, April, 2015)

[541] McLellan, B. (1992) 'Transporting Oil and Gas – the Background to the Economics', *Oil and Gas Finance and Accounting* 7(2).

being in breach of a Gas Sale Agreement with buyers, while the pipeline company would directly be in breach of the capacity contract midstream. Failing to meet booked capacities will result in penalties and poor reputation for the pipeline company.

Conversely, building pipelines with excess capacity (i.e., out with booked capacity) would be a case of 'too early investment' in infrastructure leading to low utilisation with cost implications for the investor.[542] More so, an inaccurate capacity can affect its pricing, and pricing of pipeline capacity can be a crucial problem in practice for both producers and pipeline company's revenue with resultant implications for volume at the distribution line to end users also.[543] Operating a pipeline to as close as its full capacity as possible could yield optimal return on investments for the pipeline company; increased availability of commodity downstream; and competitive price for electricity. Therefore, an accurately measured capacity is vital for achieving such optimal benefits.[544]

5.5 Regulation of access to Gas Capacity and Commodity Markets

While breach arising from capacity and commodity contracts may not give rise to a dispute under the WTO, regulation may give rise to breach of market access principles

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542 However, besides building excess capacity, other factors that may render even a pipeline built in line with booked capacity to be imbalanced include temporary decrease in market demand, weather inhibiting operations, and scheduled or unscheduled maintenance. See EIA, 'Natural Gas' based on 2007/2008 selected data available at http://www.eia.gov/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/usage.html (Last visited April, 18, 2015)

543 For an extensive analysis of pricing natural gas pipeline capacity, See Nicola Secomandi '*On the Pricing of Natural Gas Capacity*' Tepper School of Business Working Paper 2004-5 (Carnegie Mellon University, Pittsburgh, PA) July 2009.

544 For an extensive analysis on how to calculate accurate pipeline capacity, see Leif Idar Langelandsvik *et al*, *Ibid*.

which may be actionable under international trade rules. The open access to investment in pipelines and to transmission of commodity are the fruits of competition, and to a large extent, except spot markets, are regulated by States. Typically, regulation and competition seem antithetical with the former giving rise to natural monopoly[545] and the latter an element of competition, yet their relationship is somewhat complementary. While the initial goal of regulation prior to competition was to regulate monopolies with the aim of curbing abuse of monopoly power, the current goal of regulation in the European single market is to regulate third party access with the aim of curbing monopolistic competition.[546]

Although the gas market is in a post monopolistic era, the need for state regulation of antitrust law in a liberalized market structure has always been necessary to safeguard the system from market collapse that could arise from unregulated competition especially when inefficient investors are allowed open access to networks.[547] In other words, it ensures that only qualified entrants who can guarantee volume are given access, and that their entry is seamless. Besides this, it also seeks to curb abuse of capacity rights in pipelines by large undertakings i.e., to prevent abuse of dominant position that may stifle competition. This relationship between regulation and antitrust law can be drawn from the American experience in the *El Paso* case as will be seen whereby while

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545 The concept of natural monopoly stems from the premise of regulated industries, of which governmental intervention through restriction of entry is normal practice aimed at reaching economies of scale. See Joe s. Bain, barriers to new competition (Cambridge: Harvard University Press, 1956); Posner Richard A., *Natural Monopoly and its Regulation* (U.S.A, Massachusett, Canto Institute, 1999); Sanford V. Berg and John Tschirhart, '*Natural Monopoly and the Justification for Regulation' in* Sanford v. Berg and John Tschirhart, *Natural Monopoly Regulation: Principles and Practice* (Cambridge, Cambridge university press, 1989) at pp 21-52. See also, Sanders E., *The Regulation of Natural Gas (*Philadelphia, Temple University Press, 1981) at 18

546 For a general and instructive understanding of the relationship between regulation and the effects of competition on markets, see Arthur s. De Vany *et al, supra* n 512

547 Sanders E., *Supra* n 545 highlighted areas where competition can have negative consequences. Although she was of the view that monopoly is naturally more efficient than competition, such a view is no more popular.

competition brought efficiency at competitive price, regulation through Section 7 of the Clayton Act and Section 4 of the Natural Gas Act brought about market access protection and non-discrimination respectively to safeguard the benefits of competition.[548]

5.5.1 *Regulated Third Party Access to Gas Pipelines and implications for Commodity markets*

5.5.1.1 Regulated TPA and Pipeline Capacity Contracts

Third party access, which is about access to networks (a capacity issue), is widely acclaimed as a solution to the problems associated with monopoly. But there is a problem within the solution. While access to networks can bring about service efficiency at reduced costs to customers, an unabridged exposure of smaller entrants to such network-associated risks can ultimately have an effect on gas supply and cash flow as will be soon later in this section.

The European Community Regulatory Authority (ECRA) regulates the internal energy market through the design and instrumentality of the Electricity and Gas Directives.[549] The EU Directives mandate Member States to cooperate in the acceleration of market access by instituting and empowering national regulatory authorities (NRAs) with the task of ensuring and facilitating non-discrimination, effective competition in line with their liberalization and competition policy commitments under the ECT.[550] NRAs ensure

[548] Judge Wright gave an unequivocal description of the relationship between regulation and antitrust law thus: "*Despite a continuing debate, it appears that the basic goal of direct governmental regulation through administrative bodies and the goal of indirect governmental regulation in the form of antitrust law is the same- to achieve the most efficient allocation of resources possible*". At 654-655

[549] The 2003 Directives replaced the 1998 Directives to rectify the lapses in access to networks in the 1998 directive through a more thorough and strengthened provisions on electricity supply, retail supply, transmission and distribution; unbundling, regulation, international trade, and security of supply to cover loopholes in the 1998 directives that allowed integrated companies opportunities for less liberal options on access to networks.

[550] See also, Article 10 of the *ECT on the Commitment to the Promotion, Protection of Treatment of Investments.* For market access to thrive, investment protection from monopoly behaviour is sacrosanct. Generally the NRAs are given legal status in 2 ways: (1) by way of obligation on States to institute and charge one or more

access to gas transmission and distribution networks in their respective countries either through negotiated or regulated Third Party Access or both.[551]

While negotiated TPA (nTPA), like regulated TPA, involves a party gaining access to another party's facilities in other to compete, unlike regulated TPA, it is argued that prospective entrants negotiate their access to the network with the network operator without the requirement for transparency with non-uniform terms between a party to the nTPA and another party.[552] But here, we deal with regulated TPA.

With regulated TPA, the price for the use of the transmission and distribution systems cannot be negotiated. Eligible customers have a right of access on the basis that they fulfil the terms of published and supervised tariffs set by the State.[553] There are rules in place guiding TPA, and the trade effect of regulated TPA arises where a Member State violates these rules by restricting TPA resulting in limited access to transmission networks with ripple effect on volume and of course price to the final consumer.

5.5.1.2 Regulated TPA and long term Commodity Contracts

Although TPA is about pipelines while long term contracts is about commodity, there is a nexus between access to investment in pipelines and long term commodity contracts.

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competent bodies as regulatory authorities tasked with supervising network access in the internal gas market at national levels. See Article 25 (8) of the Gas Directive. States set out their functions, competences, and administrative powers. (2) While States are obligated to set out their functions, and powers, the Directive sets out minimum functions and competences in the interest of harmonization. See Recital 13 of the EU Gas Directive.

[551] Article 19 (1) of the Gas Directive.

[552] For a detailed argument for and against negotiated TPA, see Carlos Lapuerta, Boaz Moselle, "*Network Industries, Third Party Access and Competition Law in the European Union*", 19 Nw. J. Int'l L. & Bus. 454 (1998-1999). Following negotiations, access may be refused on the grounds of lack of capacity, but the directive requires that substantial reason must be given. However, entrants may take this decision to a dispute settlement body designated by the member state.

[553] Article 18 of the EU Gas Directive

While the vocation of TPA is not to facilitate long term capacity contracts but to seek open market access for new entrants, it however does not undermine long term commodity contracts. Rather, it in fact protects remnants of it. This is crucial because any measure affecting commodity will have implications for export markets. By virtue of *Art. 18 (3) of the Gas Directive,* the implementation of TPA should not prevent the conclusion of long term contracts for the supply or transportation of natural gas, in so far as they comply with competition rules. Hence, the two core areas where regulated TPA may impact on trade are as follows:

1. Where implementation of TPA prevents the conclusion of long term commodity contracts.
2. Where implementation of TPA is contracted with take-or-pay clause, thereby causes serious economic and financial difficulties for small entrants.

Historically, long term contracts by virtue of their take-or-pay commitment clauses guaranteed the security of gas supply and cash flow with some flexibility over the life of the contract.[554] In the case of non-contracted gas, the producer and pipelines will have to look for a spot buyer at a price which the spot buyer will be willing to pay for the available gas, or draw up a gas sales contract with a buyer with the promise to deliver gas on spot basis when produced. On the other hand, where pipelines already have long term supply contracts in place, they do not have to worry about volume risk when associated gas is produced because long term commodity contracts anticipate multiple deliveries in the future with the buyer's commitment to take gas, and any under-delivery can be rectified by a surplus. Therefore, a major factor in investing in pipeline capacity

[554] Take or pay formulations simply means that the buyer has the flexibility to take delivery or not to take delivery depending on its operational needs on the condition that the buyer makes payment to the seller for all quantities of gas which would have been delivered under the Gas Sales Agreement, and that the buyer has the right to recover in the future, any quantity not taken but already paid for.

is the assurance that there are long term contracts with booked capacities that will necessitate the construction of the pipeline. According to Justice Douglas;

> "In this regulated industry a natural gas company must compete for, enter into, and then obtain Commission approval of sale contracts in advance of constructing the pipeline facilities. In the natural gas industry pipelines are very expensive; and to be justified they need long-term contracts for sale of the gas that will travel them…Once the Commission grants authorization to construct facilities or to transport gas in interstate commerce, once the distribution contracts are made, a particular market is withdrawn from competition. The competition then is for the new increments of demand that may emerge with an expanding population and with an expanding industrial or household use of gas"[555]

While that case dates back to 1968, the quote is still relevant even in today's world of competition. However, in reality, this must reflect pipeline capacity constraints.

A classic example of the importance of long terms contracts is the *Benzine Petroleum* case[556] where the Court of Justice held that in the event of oil shortage, BP was justified in reducing its deliveries to its customers in favour of those customers with which it had long-term contracts.[557] Even monopolies have been known to have managed volume risk by entering into long term contracts.[558] At the time of designing the current liberalized gas market, subsisting take-or-pay commitments in long terms contracts were safeguarded.[559] In addition to this, liberalization must not preclude parties from entering

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[555] *United States v. El Paso Natural gas COY* 376 U.S. (1968) at 659-660

[556] *Benzine Petroleum Handelmaatschappij BV v Commission*, Case 77/77 [1978] ECR 1513 3 C.M.L.R 174

[557] *Ibid* at para 32.

[558] For instance, prior to its privatization by the Margaret Thatcher government in the 1980s, Britain's gas market was monopsonistic as British Gas was the only buyer of gas. Its monopoly clout meant it could manage the risks associated with the development of various individual fields for the purpose of selling to a single buyer through the implementation of dedicated 'allocation agreements' among the parties with the producer taking the production and commodity volume risk while it took the market and downstream risk. For the various allocation contracts including: allocation agreements with allocation arrangement provisions, transportation agreement, and attribution and substitution, see Paul Griffin, '*commingled streams of natural gas: allocation and attribution' in* Martyn r. David, *Oil and Gas Infrastructure and Midstream Agreements* (London, UK, Sweet and Maxwell, 1996) pp 5 - 52

[559] Article 27 (1) of the Gas Directive

into new long term contracts, provided they conform to the ideals of competition by adherence to transparency[560] and non-discrimination, and any refusal must be justified.[561] Should NRAs refuse the conclusion of long term contracts without justification, it opens the field to a porous regime whereby smaller entrants, by virtue of their access, become exposed to risks that can only be managed by commitments to long term contracts.

Meanwhile, a regulation restricting the conclusion of long-term commodity contracts to supply gas would shut out potential investors in pipelines who are willing to commit to capital pipeline costs, assume the pipeline risks, commit to long term contracts with buyers, and compete for such buyers with existing pipeline undertakings. Where the refusal of long-term contract is justified, Member States are required to ensure that the natural gas undertaking refusing access makes the necessary enhancement to the pipeline capacity where it is economical to do so, or if a potential customer is willing to pay for them.[562] This legislation is aimed at cushioning the trade effect of any refusal of long term contracts. In hindsight, it goes to show the potential trade impact a complete refusal of long term contract can have on investment in pipelines and on downstream markets.

In the event that NRs allow the conclusion of long term contracts between parties which are not transparent or are discriminatory, such an allowance would undermine the benefits of competition and subtly reinstate monopolistic behaviours. This also violates

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560 GATT Article X and GATS Article III. The WTO glossary promotes the ideals of transparency thus: "*degree to which trade policies and practices, and the process by which they are established, are open and predictable*"

561 A justification for such refusal would be on the grounds that granting entry would result in serious economic and financial difficulties where TPA is contracted with take-or-pay clause. See Article 21 (1) of the Gas Directive.

562 Article 27 (2) of the Gas Directive.

the ideals of the national treatment, most favoured nation treatment and transparency in the multilateral trading regime.[563]

5.5.2 *Refusal of third party access and abuse of dominant position*

The dilemma that comes with justified refusal of third party access is that, good intentioned as it may be to protect networks from collapse, it can feed the growth of abuse of dominant position by existing undertakings of the network, and where such *de facto* situation thrives long enough, it could undermine the gains of competition, resuscitate the monopolistic era, and negatively impact on investment decisions of would-be competitive entrants. This necessitated the 'essential facilities' doctrine.

5.6 The 'Essential facilities' doctrine

The doctrine states that a company which due to its dominant position (most likely, state companies or state enterprises or state-backed companies), owns facilities or infrastructure that are essential to other competitors in providing performance of an essential service to their customers, and which refuses such other companies access to that facility without good reason, or allows access under less favourable conditions, is abusing its dominant economic position.

Originating in the US antitrust law, by adoption, the regulation of TPA in the European market is rooted in the 'essential facilities' doctrine – albeit with some caution by the European Commission.[564] While some authors have voiced this caution such that an

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[563] GATT Articles I, III, and X respectively, and GATS Articles II, XVII and III respectively.
[564] Wälde, T.W., Gunst, A., 'International Energy Trade and Access to Energy Networks', *Oil, Gas & Energy Law Intelligence*, Vol:4, Issue: 2, August 2006, p. 18-19.

alleged abuse of a dominant position by an energy facilities owner must still satisfy all the requirements of Article 82 EC (now Article 102 TFEU),[565] others have extended it as an outright obligation on a company with dominant position.[566] Dominance in the context of this doctrine was defined by the court as follows:

> "... [a] position of economic strength which enables the operator concerned to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors, its customers and, ultimately, consumers"[567]

Its manifestation in the EU space is captured in Article 102 of the TFEU[568] (ex Article 82 EC Competition Law). It provides that "*An abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States".* The purport of Article 102 is to prevent undertakings in dominant position from implementing measures that effect the prevention, restriction or distortion of competition within the internal market.[569] One thing that stands out in Articles 101 and 102 is that there is a correlation between abuse of dominant position in the internal market and negative international trade effects. This is the platform where regulation of TPA is relevant to the WTO.

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565 Cowen, 'The essential facilities doctrine in EC competition law: towards a "matrix infrastructure' *in* Hawk (ed.), *Annual Proceedings of the Fordham Corporate Law Institute* 1995 (Sweet & Maxwell, 1996); B. Doherty, 'Just what are essential facilities?' (2001) 38 *CMLRev* 397.
566 Palasthly, 'Third Party Access (TPA) in the Electricity Sector: EC Competition Law and Sector-Specific Regulation' 2002 *Journal of Energy and Natural Resources Law* vol 20, no 1; Leo Flynn 'The essential facilities doctrine in the Community courts' Commercial Law Practitioner 1999, vol 6, no 9, pp 245-248;
567 *Compagnie Maritime Belge Transports v Commission* (Case C-396/96 P) [2000] ECR I-1365 at 34; citing Case 322/81 NV Nederlandsche Banden-Industrie Michelin v Commission (Michelin I) [1983] ECR 3461.
568 2012/C 326/01
569 Article 101 TFEU

Walde referred to Article 22 (4) of the ECT as "the most intriguing provision".[570] In essence, he noted that while other subsections invoke state responsibility for acts of state enterprises, this provision invokes state responsibility for conducts of "any" entity within its area. And that by this, the provision "*recalls the persistent - and still not fully resolved – policy debate within the European Union on "third-party access" and "essential facility" to be applied to energy transportation and distribution monopolies. As access to transportation facilities (oil and gas pipelines and storage, electricity transmission lines) is proving in fact one of the major investment problems for foreign energy investors needing access to such transportation facilities"*[571]

The doctrine has been invoked in cases relating to networks in the telecommunications services sector,[572] access to infrastructure in ports,[573] telemarketing services,[574] intellectual property rights,[575] supply services in raw materials whereby a dominant producer and supplier of raw material became a manufacturer of end product itself,[576] supply services where the dominant supplier stops supply to a customer for its link with the supplier's competitor.[577] However, the turning points of the essential facilities doctrine's application to the European single market structure was in the *Magill*

[570] Walde, T., *State Responsibility for subnational authorities and non-state national entities' supra*
[571] *ibid*
[572] *Régie des Télégraphes et Téléphones v. GB-Inno-BM S.A*, Case C-18/88, 1991 E.C.R. I-5941, [1994] 1 C.M.L.R. 117. See also Bronckers Marco, Pierre Larouche, 'A review of the WTO regime for Telecommunications Services' , *in* Kern, A., Mads A., (eds)., *The World Trade Organization and Trade in Services,* The Netherlands, Martinus Nijhoff Publishers (2008) p. 319
[573] *Port of Rødby,* Commission Decision 94/119/EC, 1994 O.J. (L 055) 52; *Sea Containers v. Stena Link*, Commission Decision 94/19/EC, 1994 O.J. (L 015) 8
[574] *Centre Belge d'Etudes de Marché- Telemarketing (CBEM) v. SA Compagnie Luxembourgeoise de Télédiffusion (CLT) and Information Publicité Benelux (IPB),* Case 311/84, 1985 E.C.R. 3261, [1986] 2 C.M.L.R. 558.
[575] *Maxicar v. Renault* Case 53/87, 1988 E.C.R. 6039, [1990] 4 C.M.L.R. 265; *Volvo v. Erik Veng (UK) Ltd*, Case 238/87, 1988 E.C.R. 6211, [1989] 4 C.M.L.R. 122
[576] *Commercial Solvents*, 1974 E.C.R. at 223
[577] *United Brands Company and United Brands Continentaal BV v. Commission*, Case 27/76, 1978 E.C.R. 207, [1978] 1 C.M.L.R. 429

judgment[578] and the landmark *Bronner* judgment[579] respectively. While these cases are not particularly about gas pipeline networks, the lessons are instructive for gas pipelines and this section will ultimately unveil its application to the gas sector alongside its attendant relationship with the WTO regime.

<u>The *PRTE and ITP v Commissioner Magill* case</u>

The *Bronner* case was preceded by the *Magill* case. The discrepancy in the ECJ's ruling in *Magill's* case and its problematic interpretations saw the ECJ in *Bronner* case bringing more clarity on the doctrine.[580] In the *Magill* case the appellant were major TV broadcasters who by exercising their exclusive rights under national copyright laws denied potential publishers of weekly television guides by refusing to grant them weekly publishing license from their copyrighted weekly television listings. This prevented potential competitors from entering the market for weekly television guides in a geographic area comprised of Ireland and Northern Ireland, a portion of the United Kingdom.

Although the ECJ in that case had rejected the Court of First Instance's ruling that it was an abuse of dominant position to exercise intellectual property rights in pursuit of an obviously anti-competitive aim,[581] on the grounds that the objective of a copyright is to

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[578] *P RTE and ITP v Commissioner Magill* (1995) ECR 1-743 joined cases C-241/91 p and C-242/91 p. (The *Magill* judgment)
[579] *Oscar Bronner GNBH & Co. KG v Mediaprint*. Commission decision OJ l 015 of January 18 1994; ECJ November 26 1998, case c-7/97, JUR 1998, Pi-7791.
[580] The ECJ, whilst analysing the context of the essential facility doctrine put the definition of abuse of dominant position in controversially vague terms by holding that the refusal to license an intellectual property right does not in itself constitute abuse, but rather it is the exercise of the exclusive right that might be an abuse in particular circumstances. This uncertainty was later put right in the Bronner judgment. At 109-112
[581] It stated that "*[r]efusal to grant a license, even if it is the act of an undertaking holding a dominant position, cannot in itself constitute abuse of a dominant position.*" para 49

grant the copyright holder the ability to restrict competition; in view of Article 86 of the EEC Treaty (now Article 106 TFEU), the ECJ agreed with the Court of First instance's judgment that the appellant had actually abused their dominant position. In finding the appellant to have abused its dominant position, the ECJ held that, "*the exercise of an exclusive right by the proprietor may, in exceptional circumstances, involve abusive conduct*."[582]

The ECJ gave this finding on the following bases: (a) There was "no actual or potential substitute" for the weekly television listings published by the appellants, and so the appellants were "the only sources of the basic information on programme scheduling which is the indispensable raw material for compiling a weekly television guide." Therefore the appellants' refusal to provide the information constituted a violation of Article 86 of the EEC Treaty; (b) That there was no justification for such refusal; and (c) Appellants exhibited monopoly control in a competitive structure by "excluding all competition in that market since they denied access to the basic information which is the raw material indispensable for the compilation of such a guide."[583]

Implying a trade effect of the appellant's action, the ECJ in agreeing with the Court of First Instance that the appellants actions had "*modified the structure of competition*" and in rejecting the appellant's argument that the effect on trade among Member States was minimal, stated categorically thus, "*In order to satisfy the condition that trade between Member States must be affected, it is not necessary that the conduct in question should in fact*

[582] paras. 49-50
[583] para 50

have substantially affected that trade. It is sufficient to establish that the conduct is capable of having such an effect."[584]

This finding triggered criticisms on two grounds. First, it created much uncertainty as regards the definition of the dominant undertaking's duty to supply a competitor by suggesting that abusive conduct may be implied only in *exceptional circumstances*; and by eventually finding the refusal a violation of Article 86 of the EEC Treaty (i.e., this particular refusal was an exceptional circumstance outside the ordinary protection of intellectual property right)[585], its reference to this case as exceptional circumstance was watery and unnecessary. And secondly, since the case involved intellectual property rights, such a ruling should not be applied to intellectual property since companies would be obliged to share their assets and more importantly intellectual property rights, with competitors, in spite of the social and economic costs involved.[586] In general, such finding suggests that an undertaking, merely because of its dominant position, could be required to grant access to its facility, regardless of whether it is a monopoly or not, and regardless of other economic elements of the facility. The *Bronner* judgment sought to rectify this controversial ruling.

[584] *ibid*

[585] The court found exceptional circumstance in the fact that (1) the refusal concerned a product the supply of which was indispensable for carrying on the business in question, in that without that information, the person wishing to produce such a guide would it impossible to publish it and offer it for sale (para 53), the refusal prevented the appearance of a new product for which there was a potential consumer demand (para 54), it was not objective (para 55), and so it was likely to exclude all competition in the secondary market of television guides (para 56)

[586] Subiotto, Romano "the right to deal with whom one pleases under EEC competition law: a small contribution to a necessary debate" (1992) 13(6) ECLR 234. More so, Korah viewed the case as a potentially dangerous intervention of the court in applying competition law to the discipline of intellectual property rights. See Korah, Valentine "The Ladbroke saga", (1998) 19(3) ECLR 169

The *Oscar Bronner GnbH & Co. KG v Mediaprint* case

The Bronner case was concerning a refusal to allow Bronner access to Mediaprint home newspapers delivery service. Unlike the *Magill* case, the *Bronner* case rightfully did not distinguish exceptional from non-exceptional circumstance. As long as act of refusal contained all the ingredients of abuse, there is abuse of dominant position. The court considered three essential elements that would constitute abuse of dominant position. First, if the refusal was likely to eliminate competition in the daily newspaper market on the part of the person requesting access, secondly, if such a refusal cannot be objectively justified, and thirdly, if the service for which access is requested is in itself indispensable to the business of the person requesting access as long as there are no actual or potential substitute in existence for that home delivery scheme.[587]

The court found that the elements were not present on the ground that: (a) there were alternative methods of distributing daily newspapers available to Bronner, such as by post and through sale in shops and at kiosks, even though they may be less advantageous for the distribution of certain newspapers;[588] (b) that there are no technical, legal or economic obstacles to render it impossible or difficult, for any other publisher of daily newspapers to establish, alone or in cooperation with other publishers, its own nationwide home-delivery scheme and use it to distribute its own daily newspapers;[589] and (c) it is not enough to argue that the alternatives were not economically viable since it would lead to only small circulation of the daily newspaper

[587] Para 41
[588] *Ibid,* para 43
[589] *Ibid,* para 44

to be distributed.[590] Instead, it must be proved that it is not economically feasible to create a second delivery scheme for the distribution of daily newspapers with a circulation comparable to that of the daily newspapers distributed by Mediaprint.

By this finding, the court in the Bonner case set a higher and stricter standard for the application of the essential facilities doctrine by maintaining a central position that the facility in dispute was not indispensable since there were alternatives, regardless of whether the alternative was economically viable or not.

<u>*A Critique of the Bonner Judgment*</u>

There have been scholarly opinions on the *Bronner* judgment.[591] Advocate General Jacobs particularly sides with the ECJ in dismissing the 'economic viability of the alternative' argument.[592] Understandably, not all refusal of entry is inherently anti-competitive. The duty to allow entry must be weighed against the implications of that duty if it would encourage inefficient entry, and so refusal may be justified in instances of inefficient entry of smaller players. That said, understandably also, the court based its position on the premise that the economic viability argument would only be relevant if

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[590] *Ibid,* para 45

[591] See Barry Doherty, *Just What are Essential Facilities?'* 38 Common Mkt. L. Rev. 397, 432 (2001). The author noted that the key elements were that the facility is indispensable, the refusal is likely to eliminate all competition, and lastly, the refusal is unjustified. See also Opinion of Advocate General Jacobs, *Bronner,* delivered on 28 May, 1998 on Case -7/97 E.C.R at 1-1779.

[592] See Opinion of Advocate General Jacobs, *supra* at para 68 – 69. Advocate General Jacobs in his comprehensive opinion stated that while it would be necessary to establish that the alternative being uneconomic would deter investment by enterprising publishers who were convinced there was a market for another large daily newspaper, such losses can be anticipated in the short-term. But more importantly, to hold the argument that the alternatives were uneconomic would be to give the European Community, national regulatory authorities and the courts to be engrossed in detailed regulation of the Community markets, entailing the fixing of prices and conditions for supply in large sectors of the economy. And that "intervention on such a scale (over-regulation) would not only be unworkable but would also be anti-competitive in the longer term and indeed would scarcely be compatible with a free market economy".

Bronner sought to create a second delivery scheme for distribution that is as large as those distributed by Mediaprint. So, the question that comes to mind is, could Bronner still be competitive with an alternative delivery scheme for distribution within the limits of its capacity as a smaller player? An answer in the affirmative would justify the courts thinking. Admittedly, in the short term it might not be economically rewarding but that should not lead to the conclusion that it would not be economically viable in the long term. So the issue would be whether such investment would be 'feasible' in the short term even though not economically rewarding in that short term.

On the contrary though, if delivery on the investment is only feasible with a second delivery scheme for distribution that is as large as those distributed by Mediaprint, then such an investment would be altogether economically unviable. The refusal of entry in this circumstance would be clearly anti-competitive. On this note, a line of caution must be drawn in the Bronner judgment though. The existence of an alternative may mean investment is feasible for smaller layers, but it may be difficult to judge economic viability in the long term. This would specially be the case where a smaller investor may not require an investment in a delivery channel, and any investment in such capacity would be lead to over-investment, which would have the negative ripple effect on their bottom line – hence, bringing us back to the economic viability argument. A blanket application of the Bronner judgment would be undermining the important role economic viability of building a new infrastructure can have on influencing investment decisions in such an infrastructure. This is because the mere availability of an alternative network should not be loosely interpreted as economic viability.

5.6.1 *Application of doctrine to Gas Pipelines and Implications for International Gas Trade*

The critique above is crucial to gas pipelines in two ways. First, in most cases building pipelines demand huge capital investment. Perhaps this explains why pipeline undertakings are mostly a monopoly in the first place. For new entrants to build new networks, they must deal with mobilisation costs of contractors; communications and control systems; difficulty with terrain such as road and river crossings; way leave cost; costs of compressor stations and terminals; steel and welding costs; and environmental costs.[593] With all of these, money must matter. It is hardly economically viable for new entrants to build new networks let alone compete once built. Secondly, a requirement that a new entrant must prove that the alternative pipeline's capacity would be as high as the dominant pipeline company's capacity before it could claim the project is not be economically viable would assume it's more feasible to build a smaller capacity without considering other factors listed above in building network altogether. For them, building a new network even though within capacity would negate any viability of returns on investment in the long term. That would amount to risking over-investment incurring heavy sunk cost rather than secure revenue from the pipeline.

On a general note, the question of what constitutes an essential facility and when refusal to provide access amounts to an abuse of a dominant position is deeply relevant to measures implemented by pipeline undertakings in the gas sector. Going beyond the plenary standards of Article 101 TFEU, it has been suggested that facilities would not be 'essential' if a competitor can be reasonably expected to build such facilities himself; if the business was not so strategic; when competition was already existing; when facilities

[593] Omonbude, E.J., *supra* n 512

are reasonably new; and where barriers to entry are temporary and not overwhelming.[594] To what extent are these elements justify the application of the doctrine to pipelines in the natural gas market? We examine the primacy of this doctrine from case law in the gas market in the *El Paso* case below.

5.6.2 The *United States v. El Paso Natural Gas Coy*[595] case

The landmark US case of *United States v. El Paso Natural Gas Coy* is essentially about the propriety of mergers rather than a non-discrimination case; however, it provides a flashlight into the doctrine's application in pipeline networks. In that case, El Paso Natural Gas Company (El Paso), was a pipeline monopoly transporting gas to distributors at the California border in 1954 sought to acquire Pacific Northwest Pipeline Corporation (PNW) and that purported acquisition was the subject of the suit against El Paso. Pacific Northwest Pipeline Corporation (PNW) was a pipeline operating Company which constructed and was successfully operating a pipeline from the San Juan Basin in New Mexico to the State of Washington to supply gas to the then Pacific NorthWest.

PNW then sought to enter the rapidly expanding California market as a new entrant by negotiating to offer more steady gas supply from Canada to Pacific Gas & Electric Co in northern California in 1954 and 1955, and to Southern California Edison Co. (Edison) in 1956 with the aim of winning their patronage away from El Paso. Because PNW had no pipelines in California, its efforts were unsuccessful, however, its presence was an element of competition in the California market and its offer led to price reduction and other concessions to the benefit of Edison. This forced El Paso to lower its selling price

[594] Wälde, T.W., Gunst, A., *Supra* n 564 at 20
[595] 376 U.S (1968) 84 S.Ct. 1044, 12 L.Ed.2d 12

by 25 percent and provide a much steady supply. El Paso in its dominant position, eventually acquired 99.8 percent of PNW's outstanding stock by May 1957.

In July 1957, the US Department of Justice filed a suit against El Paso in the US District Court for the District of Utah on the ground that the acquisition by El Paso was intended to prevent PNW from competing with El Paso for the natural gas market in California. And later, that it was in violation of Section 7 of the Clayton Act.[596] The Natural Gas Act also played a role in safeguarding competition.[597]

Upon appeal by the US to the Supreme Court following the District Court's dismissal of its suit, the Supreme Court reversed and directed the District Court "to order divestiture without delay"[598] Although the US and EL Paso agreed to a divestiture decree which the District Court entered, the District Court refused to permit Cascade Natural Gas Company and others to intervene and be heard, leading to delays in the divestiture. Upon appeal again, the S.C reiterated its order and the reason behind its mandated order in very explicit terms thus,

> "*That mandate in the context of the opinion plainly meant that PNW or a New Company be at once restored to a position where it could compete with El Paso in the California market... Our mandate directed complete divestiture. The District Court did not, however, direct complete divestiture. Clearly this [the District Court's Decree] does not comply with our mandate. The*

[596] Section 7 of the *Clayton Antitrust Act* (1914) 15 U.S.C. § 18 is the principal US federal substantive law governing mergers, acquisitions, and joint ventures. It prohibits not only the acquisitions of "stock" but also the acquisitions of "assets" where "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." Section 7 is mainly enforced by the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC). Inasmuch as the dominant undertaking's reduction in its selling price was forced by competition rather than by regulation, regulation played a subsequent role through the enactment of Section 7 of the Clayton Act.

[597] Section 4 (a) of the Natural Gas Act, 15 U.S.C 717C (b) (1964) prohibited suppliers from discriminating through preferential and unreasonable rates. Because of this law, a reduction of price to this customer meant every other customers of EL Paso benefitted from the drop in price and improved efficiency. More so, by virtue of section 5 (a) of the Act, the commission was vested with authority to set reasonable rates should it establish that prior rates were exploitative.

[598] 376 U.S. *ibid* at 651

severance of all managerial and all financial connections between El Paso and the New Company must be complete for the decree to satisfy our mandate." [599]

While this case was not about El Paso directly refusing pipeline access to PNW but rather about the propriety of El Paso's acquisition of PNW in violation of the Clayton Act not to acquire or facilitate mergers in a way that harms competition, the principle governing abuse of dominant position is still not lost. Going by Article 101 TFEU which categorically prohibits, amongst others, "*all agreements between undertakings… which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market*" (emphasis mine); as well as Article 102 TFEU which provides that abuse may consist in amongst others "directly or indirectly imposing unfair purchase", it can be deduced that the agreement to acquire PNW entered between EL Paso and PNW, and which would potentially affect gas transportation from Canada to California, had the motive of preventing or restricting PNW from competing with El Paso. Therefore, the acquisition measure clearly violates Article 101 and 102.

Meanwhile, even though competition was already existing, an element which according to Walde and Gunst would make a claim against any company in dominant position of essential facilities unsuccessful, such competition would be flawed in the areas where pipeline networks remain an essential facility as dominant undertakings are commonplace. Moreover, it is fair to assert that since pipelines are mostly natural

[599] *Ibid* at 471- 472. See also., S.C in *Cascade Natural Gas Corp v. El Paso Natural Gas Co*. 386 U.S. (1967) 129, 87 S.Ct. 932, 17 L.Ed. 2d 814 at 937.

monopolies in spite of the TPA regime, competition in pipeline markets is considerable minimal compared to competition in commodity markets.

5.7 <u>Essential Facilities doctrine and Market Access significance for the WTO regime</u>

The significance of the *El Paso* case to the WTO is rather hinged on the relationship between the WTO and the market access principle. Broadly speaking, the case relating to prevention of access into a domestic market, goods of 'Like Product' with the domestic good for the purpose of stifling competition brings about that link as it goes to reflect the primacy of the 'market access' challenge even in the gas sector. And as natural gas increases its share in the energy consumption mix, what this means for the WTO is that disputes of this nature, or of any nature relating to market access may find its way to the WTO dispute panel especially as players like Russia, with significant gas export through pipelines into destinations in the European single market, have gained accession to the WTO. This has the potential to upgrade the WTO's stake in the gas sector.

5.7.1 *Market Access in Natural Gas Markets Vs Competition in WTO Law*

The above case law analysis puts the relationship between international trade law and competition in the spotlight. There have been notable discussions on the need for an interaction between international trade law and competition policy.[600] And one of such

[600] *See* WTO Ministerial Conference, *Singapore Ministerial Declaration,* WT/MIN(96)/Dec, 20 (Dec. 18, 1996), available at http://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.htm (last visited January 18, 2015); *see also* WTO report of 1998 of the Working Group on the Interaction between Trade and Competition to the General Council, *WT/WGTCP/2* at para 22 to 24; *see also* OECD, competition and trade policies: their interaction (1984), available at http://www.oecd.org/dataoecd/7/51/2375610.pdf (last visited January 18, 2015); OECD Trade Commission, *Interrelationships between Competition and Trade Policies,* OECD Doc. TD/TC/WP(92)20/Rev2 (April 20, 1993); see the fourth session of the ministerial conference held in Doha, Qatar which set the legal basis for launching negotiations on the interaction between trade and competition policy, WTO ministerial conference, *Doha Ministerial Declaration,* WT/MIN(01)/Dec/1 (Nov. 20, 2001), available at http://www.wto.org/english/thewto_e/minst_e/min01_e/mindecl_e.htm (last visited January 18, 2015). Paragraph 23 authorised WTO members to agree to enter negotiations on the

platform requiring such interaction is the EC internal market. As David Luff puts it, "in the EC, the rules of the WTO may help entrants and the Commission to enforce market access and competition principles within the internal market."[601] However, as it stands today, the WTO has withdrawn any further work on competition policy due to lack of consensus by Member States on modalities for negotiations in this area.[602] That said, the 'protection of competition' still remains one of the core principles of the WTO- albeit as a general guiding principle. These principles as they apply to market access in the gas sector are evident in the GATT and GATS rules respectively.

5.7.1.1 The GATT rules

As with the EU Gas Directive, the GATT likewise promotes competition and non-discrimination as a direct binding obligation on all Member States equally, except Article II which provides for varying tariff disciplines for Member States according to each State's negotiated schedules of commitment upon accession. Such GATT rules on competition includes the prohibition of non-tariff restrictions to imports or exports by any Member State (Article XI:1), the most favoured nation treatment of non-discrimination (Article I), and the national treatment obligation of non-discrimination (Article III). While EC competition law seeks to abolish public monopolies, the GATT rules makes room for the performance of public monopolies. It seeks to regulate the

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interaction between trade and competition policy for a multilateral framework. They however failed to enter these negotiations.

[601] Luff D., '*Multilateral Trade Issues and Liberalization: Current and Future Perspectives*' in Geradin Damien (ed) *Supra* n 526 at p. 334

[602] In the "July decision" of 2004 (also known as the "July package" of 2004) adopted August 1, 2004, the WTO General Council stated that competition policy "*will not form part of the work programme set out in that declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha round*". As a result, the working group was wound up and the negotiations, jettisoned.

activities of public monopolies through the provision on State Trading Enterprise (Article XVII) by ensuring their activities do not result in obstacles to trade. Also, the exception provision under Article XX gives allowance for implementation of measures necessary to the enforcement of monopolies.

According to Article XX (d);

> *"…nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures […] necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of the agreement, including those relating to […] the enforcement of monopolies operated under paragraph 4 of Article II and XVII…"*

Under the EC regime, competition law in the gas market enables market access to private entities to compete against each other. By implication, market forces, rather than protectionism, become the driving force behind policy. Hence, where market forces such as seasonal or peak demand (swings) have a negative impact on entry/investments, there is no breach of WTO rules. In such instances, the industry simply, and naturally, responded to market forces thereby making it a matter not for the WTO.[603] Whereas by virtue of Article XVII of the GATT, it may be necessary for public authorities or monopolies to drive market conditions. But where these monopolies implement measures in discriminatory manners such that they undermine the ideals of competition, impede market access, and nullify or impair expected benefits under the WTO, such deliberate measures are said to have the potential to give rise to an action under the WTO.[604]

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[603] In fact a Panel observed that the EC is meant to be the natural regulator of liberalized public monopolies, and that this aspect of competition is not part of the WTO framework as of yet. See Panel Report in *Japan – Measures affecting Consumer Photographic Film and Paper*, WT/DS44/R. paragraphs, 10.52 – 56 and 10.82.

[604] Luff, D., *supra* n 601 at 333. In striking a balance between international trade rules and national competition laws, Luff summarised thus, "*despite the lack of international competition rules, in sectors open to international trade which may still be subject to domestic monopolies, international trade law can be used to foster the adoption in domestic markets of certain principles of competition or liberalization procedures necessary to impede that market access or equal conditions of competition are impaired by these monopolies*" at 334.

Also, large undertakings who own pipelines may not be classed as State Trading Enterprises, but one thing we saw from the *Bronner* and *El Paso* judgments is that even in competition, such undertakings are *de facto* monopolies and they employ their dominant position to restrict access to gas pipelines (i.e., monopolistic competition). Unlike in the oil sector where NOCs are STEs, since undertakings and not STEs, Article XVII of the GATT would not be applicable. Rather such measures would fall under Article XI:1 of the GATT.

Where it relates to refusal of access to gas commodity, i.e., supply restrictions, while restrictive requirements for entry into the supply chain are not binding since they are not emanating from the State, their restrictive requirements fall under "administrative guidance". The Panel in *Japan – Trade in Semiconductors* found that the 'administrative guidance' played an important role in the enforcement of supply restrictions, and that as long as there are reasonable grounds to believe that sufficient incentives or disincentives existed for non-mandatory measures to take effect, there could be therefore no doubt that they fell within the range of measures covered by Article XI.1. [605]

5.7.1.2 The GATS Rules

Networks also encompass trade in supply services. The GATS similarly contain rules on competition including the Most Favoured-Nation Treatment (Article II) which applies to monopoly suppliers under Article VIII; transparency obligation (Article III); Market Access (Article XVI); National Treatment (Article XVII); Reasonableness, objectivity and

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[605] Report of the Panel, *Japan – Trade in Semiconductors* adopted on 4 May 1988 (L/6309 – 35S/116) para 106 - 112

impartiality of domestic regulation (Article VI); and access of public monopolies (Article VIII.1). The Most Favoured-Nation Treatment applicable to trade in service by virtue of Article II, subject to the exemptions set out in the Annex provisions on Article II,[606] places an obligation on WTO Member States to ensure that services and service suppliers regardless of their origin are granted equal treatment when accessing markets.[607] This applies to both *de jure* and *de facto* discrimination.[608]

While the Annex provisions makes some exemptions for States to derogate from this obligation such as in the areas of: Movement of natural persons supplying services under the Agreement; air transport services; financial services; maritime services; and telecommunications services;[609] 'energy services' is clearly missing from the list as a category of its own. Access to pipelines is access to trade in a service that facilitates the trade in gas commodity as goods. In most cases in the industry, pipeline monopolies have been granted special or exclusive rights as those akin to State Enterprises. This puts them in dominant positions, and so fall under the obligation set out Article II GATS. On this note, Article VIII GATS is clear. Article VIII provides thus:

> *"Each Member shall ensure that any monopoly supplier of a service in its territory does not, in the supply of the monopoly service in the relevant market, act in a manner inconsistent with that Member's obligation under Article II and specific commitments".*

[606] Para 2
[607] Para 1. The MFN treatment would then seem incompatible with the EC internal market which connects only States within the Community. However, because gas markets are not global but regional, the application of the MFN treatment in the context of the EC internal market is reasonable.
[608] See Appellate Body Decision '*EC – Regime for the Importation, Sale and Distribution of Bananas*' WT/DS27/AB/R
[609] See Annex on Article II Exemptions

While this may suggest that under no circumstance can states derogate from their obligations of MFN Treatment in energy services, Article 27 (2) of the Gas Directive shows otherwise. Article 27 (2) G-Directive categorically requires Member States, or the designated competent authority, to notify the Commission without delay of its decision to grant a derogation, together with all the relevant information with respect to the derogation.

Perhaps this typifies the narrative that the EC laws are more direct and specific in addressing issues relating to energy, even though application to the energy sector can be inferred from the WTO rules, thereby making it applicable. This inspires the discussion on competence in spite of applicability analysed in Chapter 3. That notwithstanding, exemptions in the natural gas market may be inferred in the Annex provisions under the heading 'Annex on Movement of Natural Persons Supplying Services under the Agreement', which of course may apply to investors in pipeline infrastructure as 'natural persons'.

5.8 <u>The 'Mandatory versus Discretionary Legislation' doctrine and its relevance to the EU Gas Directive - WTO relationship.</u>

An instructive way to determine whether a regulatory measure in the gas industry can give rise to an action under the WTO can be found in the 'mandatory versus discretionary legislation' doctrine as interpreted by several WTO Panels and Appellate Bodies.[610] The doctrine advocates that only legislations that mandate authorities to take

[610] Panel Report '*United States - Taxes on Petroleum and Certain Imported Substances*' adopted 17 July 1987, l/6175 – 34s/136; Panel Report '*EEC – Regulation on Imports of Parts and Components*' adopted 16 May 1990, l/6657 – 37S/132; Panel Report, *US – Measures Affecting the Importation, Internal Sale and Use of Tobacco,*

WTO-inconsistent actions are challengeable before the WTO Dispute Settlement Body. And where the legislation is discretionary, even if it is to do an act that is WTO-inconsistent, it does not inherently constitute a violation of the WTO obligations unless is it eventually exercised by the executive authority.[611] The issue of whether the EU Directives requiring Member States to implement regulatory measures at their national levels is subtly mandatory or outright discretionary becomes relevant to the discourse. This is especially where the measures, if applied in a discriminatory or restrictive manner, could eventually have negative trade effects for gas.

In the *EEC- Regulations of Imports* case, in arguing that Article 13:10 of the Council Regulation (EEC) No. 2423/88 was WTO-inconsistent, Japan cited the Panel in *US-FIRA* to argue that the legislation falls within the term 'requirement' and therefore qualifies as 'mandatory'.[612] But the Panel did not give the term a wide interpretation. Rather it put Article 13:10 in context. Article 13:10 provided that upon meeting certain laid down conditions (which it listed) under which States are required to impose anti-dumping duties on imported products, "Definitive anti-dumping duties <u>may be imposed…</u>on products that are introduced into the commerce of the Community after having been assembled or produced in the Community".[613]

B.I.S.D. 41S/131 adopted October 4, 1994. para 118; Panel Report, *US – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada,* WT/DS236/R, adopted 27 September, 2002. para 7.129; Panel Report, *US – Anti Dumping Act 1916,* WT/DS136/R, adopted 31 March 2000. para 6.82; Appellate Body Report, *US – Anti Dumping Act of 1916,* WT/DS136/AB/R, WT/DS162/AB/R, adopted 28 August, 2000; Panel Report, *US – Subsidies on Upland Cotton* WT/DS267/AB/R, adopted 3 March, 2005. para 7.745-6;

[611] Panel Report in [*US – Tobacco*] *supra.* The panel found that "*only the actual application of such legislation inconsistent with the General Agreement could be subject to challenge*". See para. 118. See also the Panel in

[612] The Panel in *US- Canada FIRA* case BISD 30S/140 took the view that certain undertakings might fall within the meaning of the term "requirement" in Article III:4 of the GATT in view of the fact that these undertakings were legally enforceable.

[613] Article 13:10 (a)

While the legislation proffers a requirement to impose anti-dumping duties, it was contingent on a state meeting some conditions. Therefore, if a state did not choose to meet those conditions, the legislation will not apply. The Panel stated categorically thus: "*Under the rules of the General Agreement and the Anti-Dumping Code acceptance of undertakings was not mandatory but left to the discretion of individual contracting parties. The EEC was practically the only contracting party which frequently accepted undertakings in the context of anti-dumping investigations*".[614] Likewise, in *US- Taxes on Petroleum,* the Panel in holding that tax on certain imported substances was WTO inconsistent, took into consideration the fact that the legislation "*had been enacted, was mandatory, and [by its provision] the tax authorities had to apply it after the end of the next and hence within a time frame within which trade and investment decisions that could be influenced by the tax are taken*"[615]

It is apt to note that the EU Directive in itself is arguably not a regulation *per se.* But it is the product of a regulation, which in this case is the EEC Treaty.[616] While regulation is binding in its entirety, a directive tasks Member States on setting up national authorities towards achieving the ends of competition to which they have made commitments under the European Community Treaty (EEC Treaty). In other words, Member States are not obligated to follow uniform rules in fulfilling the EU's objective of competition in the internal market. Rather, they have the discretion of administrative process in the

[614] para 3.49
[615] para 5.2.2
[616] Article 189 EEC Treaty

implementation of directives, in so far as they must meet the standards of competition obligated under the ECT.[617]

By virtue of Article 189 of the EEC Treaty a directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. To stretch Article 189 further, the Community, not States, is *mandated* to adopt directives, and each Member State are *mandated* by the Directive to set up structures aimed at fulfilling the EC's mandate. And decisions of states' national regulatory authorities instituted pursuant to the EC Directive are binding on Member States it applies to. But States are *not mandated* to follow uniform procedures in instituting regulatory authorities. What is clear from this provision is that there is a binding directive.

However, the fact that the directive does not place an obligation on states to follow uniform rules but leaves the issues of timeline, process, and framework to the discretion of states – an outcome that is binding only when Member States have designed a structure within their borders to facilitate the principles of TPA, still goes to feed the notion that it is not a binding legislation in its entirety. Whichever the case, a conclusion that it is non-mandatory would automatically put acts of NRAs, which may inhibit

[617] Weatherill, S., *Addressing problems of unbalanced implementations in EC law: Remedies in an Institutional Perspective', in* Kilpatrick, Novitz, and Skidmore (eds) (2000), *the future of remedies in Europe,* Oxford: Hart Publishing, forthcoming; Jo Shaw, *Law of the European Union* (Hampshire and New York, Palgrave law masters, 3rd ed. 2000) at 244; see also, the EEC (article 189) and Euratom (Article 161) treaties. See also cases 188 to 190/80 *France, Italy, and UK v. Commission* [1982] ECR 2545 at pp. 2573-4, where the court noted that while a regulation creates rights and obligations for Member States of the community, a directive can only be addressed to, and therefore binding upon Member States. However, it may not of itself impose obligations on individuals see case 148/78 *Ratti* [1979] ECR 1629 at p. 1645; case 152/84 *Marshall* [1986] ECR 723 at p. 749

market access, outside the scope of the WTO. Conversely, where a mandate is inferred, the WTO rules would apply.[618] This is a matter for interpretation.

Nonetheless, there is the argument that the threshold for the WTO rules applying should not be strictly limited to whether the legislation is mandatory or non-mandatory on the grounds that insistence on the doctrine, despite a legislation being WTO-inconsistent, simply because it is non-mandatory exposes states to risk of violation of their WTO obligations and undermines the safety and predictability of trade. [619]

Panels have taken the position that even a non-mandatory legislation that is WTO-inconsistent, **especially when exercised by private operators** can be subject to challenge under Article XI of the WTO on the basis of the 'administrative guidance' argument.[620] This position fits well where private operators exhibit abuse of dominant position by restricting entry to pipeline infrastructure to other private operators. Even more, in the UK, acts that constitute abuse of dominant position includes directly or indirectly imposing unfair pricing or other trading conditions, discrimination in conditions of transactions, and in fact, limiting production.[621]

5.9 <u>The 'State attribution' doctrine and its relevance to gas market regulation</u>

As private entities such as pipeline operators, transmission service operators, and downstream distributors engage in contractual streams with each other, any contractual

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[618] Luff, D., *supra* at 354
[619] Julien Chaisse, '*Deconstructing the WTO Conformity Obligation: A theory of Compliance as a Process*' Fordham International Law Journal, 2014, Vol 38, Issue 1, p. 90
[620] See *Japan – Trade in Semiconductors, supra* n 605 paras 106 – 109. See also, Panel Report, *Japan – Measures Affecting Consumer Photographic Film and Paper, Supra* n 456.
[621] Section 18 of the UK Competitions Act 1998.

breach resulting in disruptions of gas commodity is on the surface, non-governmental – i.e., purely commercial in nature. And since only acts of national governments and separate customs territories which qualify as measures are directly subject to WTO obligations, the default response is to see such acts as un-actionable under the WTO. The possibility of their being actionable under the WTO can only be imagined through the lens of the State attribution doctrine just as with acts of NOCs in the regulation of oil trade-related investment measures.

But unlike oil where NOCs are arguably State Trading Enterprises or State-controlled, or State-owned, which makes Article XVII of the GATT applicable, private operators or undertakings in the gas sector do not have such affiliations with State authorities as liberalization gives them complete autonomy from State control. States only exert some form of control in a liberalization through regulation of entry as well as create the level playing field for private entities.

However, the Panel in *Japan – Film* attempted to determine whether private actions can qualify as measures to invoke the doctrine of State attribution. According to the Panel,

> *"while this 'truth' [that only national governments and separate customs territories are directly subject to obligations] may not be open to question, there have been a number of trade disputes in relation to which panels have been faced with making sometimes difficult judgments as to the extent to which what appear on their face to be private actions may nonetheless be attributable to a government because of some governmental connection to or endorsement of those actions."*[622]

And while the Panel identified "sufficient government involvement" as the decisive criterion for whether a private action may be deemed to be a governmental "measure",

[622] Panel Report, *Japan – Film, supra* n 456 para 10.52

it went on to find that "*that possibility will need to be examined on a case-by-case basis.*"[623] But another salient question is, do acts of private operators really restrict export of gas? In other words, is a disruption of volume arising from failure of performance to meet market demands analogous to a 'restriction'? I am of the view that disruptions along the value chain may not be classed as restrictions within the meaning of GATT rules. However, where the private undertaking is big enough to exude monopoly attributes by acting in a discriminatory and non-competitive manner refusing other entrants access to infrastructures in their domain, the principles applicable to 'administrative guidance' discussed above would apply.

5.10 Transit Pipeline Regulation and their Trade Effects

There cannot possibly be international trade in oil and gas via pipeline without the transit country. Transit countries have been regarded as one of the most important elements in a pipeline project.[624] Therefore, the success of a pipeline project is dependent on the measures of the transit countries. Besides their individual regulation, for trade in gas to be possible, the different flow-through countries must have their grids interconnected. The European natural gas grid is a perfect example.

[623] *Ibid*, para 10.55-6

[624] Thijs Van De Graaf, *supra* n 1. Also citing Omonbude, *supra* where it was observed that transit countries tend to squeeze more rents from suppliers through threats of interruption of deliveries or off-taking more than legally entitled from the transmission line, the author submitted that transit countries have the balance of power in natural gas supplies, even though they are neither producers nor primary consumers.

5.10.1 *Regulated TPA, Transmission Systems Operators and Transit Pipelines*

By virtue of *Article 18 (2) of the Gas Directive,* States must facilitate cross-border transmission of gas by ensuring that transmission system operators (TSOs) seeking to transmit gas across borders shall have access to the network of the other transmission system operators. Clearly, open access to cross border TSOs facilitates trade in pipeline gas, and any refusal of access through regulation restricts trade. The salient issue then becomes whether, just like with transmission in the internal energy market, access to TSOs that do not meet the standards for ensuring transmission across borders undermines trade flows. Russian gas pipelines travel through transit countries to as far as Germany and the United Kingdom. Pipelines run from Norway to Denmark, and from the United Kingdom to Belgium.[625]

5.10.2 *Transit Pipelines from outside the Single Market*

All of Russian gas pipelines at some point pass through Ukraine to supply gas directly to majorly Germany,[626]France,[627]and Italy.[628] These pipelines have Poland, Belarus, Czech Republic and Austria as other transit countries (see generally, Figure 2). In the future, the countries in the Southern Gas Corridor category are tipped to play significant roles in the EU to import about 60 to 120 billion cubic metres of gas per year of its gas

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626 Germany imports 34% of its gas consumption from Russia

627 France imports 23% of its gas consumption from Russia

628 Italy imports 27% of its gas consumption from Russia

from the Caspian and Central Asia region as a diversification policy away from the Russian/Ukraine route.[629]

Figure 2

Transit regulation (or transit measures) comes in different ways and from different sources.[630] Regulation would depend on first, who owns the pipeline; and secondly, what territory it is transiting. A pipeline traversing a territory does not necessarily make the government of that territory the owner of that section of the pipeline. But the sovereignty element means the government, by default, has some level of regulatory capabilities over the pipeline, and the way it chooses to so regulate could, and have been known to, have serious implications for international gas trade. Two systems or models

[629] See 'Communication from the commission to the European parliament, the council, the European economic and social committee and the committee of the regions', second strategic energy review: an EU energy security and solidarity action plan, Brussels, 13.11.2008 com (2008) 781 final.
[630] Energy Charter Secretariat, '*Energy Transit- The Multilateral Challenge*' (ECS 1998) 14-15. Both commercial and political risk which includes regulatory interventions.

of pipeline agreements have been identified to give some clarity to the complexities involved in pipeline ownership and regulation.[631]

A system is the '*connected national pipelines model*' whereby regulation (not ownership) of a cross-border pipeline is segmented. That is, it is subject to the domestic law of the territory of the country through which it traverses. The contractual framework of such pipelines are a construct either between the governments of each country involved or between the pipeline owners and the operators on the one side and the governments of each territory on the other side.[632] What that means is that the same pipeline could have several contractual regimes. Another system is the '*international pipeline project*' whereby from the onset, the pipeline agreement is designed and operated as a single integrated pipeline entity and requires the multilateral cooperation of all the governments involved in the form of intergovernmental pipeline agreements.

Unlike in exploration and production agreements where the host state sets the ground rules and administers them through their NOCs, in the case of transit agreements with parties including: a crude oil supplier country or pipeline owner as an investor, a transit country, and a destination country, the transit country is the one required by the pipeline owner to ship a specified amount of quantity (*per metric ton)* to consuming markets for which it is paid a *transit fee* for right of way. In crude oil, ownership of pipeline does not lie with the transit country but with the state that built the pipeline even though sections of the pipeline are within the territory of the transit country.

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631 see Vinogradov, S., "*Cross-border Oil and Gas Pipelines: International Legal and Regulatory Regimes*", University of Dundee, 2001

632 *ibid*

Consortium of private companies are also known to own pipelines and enter into pipeline agreements with producing, transit, and destination governments.[633] The negative trade effect outcome or success of international pipelines involving all these players (pipeline owners and, pipeline operators, commodity suppliers, local communities, and governments) in whichever system ('connected national pipelines model' or 'international pipeline project') to a large extent depends on whether the transit country is a 'pure transit' country or an 'off-taker' transit country. It becomes imperative to understand how these two types of transit countries affect international trade in gas.

5.10.3 Pure Transit States (Non off-taking States)

Transit states could attempt to arbitrarily increase transit fees to lift more revenue from the pipeline. This is especially where the transit state is not an off-taker (that is, a state with stake in the pipeline but not in the commodity). Pure transit states tend to have a 'nothing to lose' mindset. They could also, in their capacity as 'host states' to the pipelines, capture rent either as compensation for maintaining the portion of the pipeline within its territory or as compensation for simply giving up part of its sovereignty for the progress of the pipeline. The lack of comprehensive international law governing transit countries who are not privy to a pipeline agreement as is the case with the national treatment regime for non-transit issues allows this arbitrary behaviour to thrive. And this arbitrariness of pure transit states is known to inhibit trade via pipelines.[634] This

[633] A few examples of privately owned pipelines include the Caspian Pipeline Consortium (CPC), the South Caucausus Gas Pipeline (SCGP), the Baku-Tbilisi-Ceyhan (BTC) pipeline, etc. See www.caspiandevelopmentexport.com (Last visited 10 January 2014).

[634] The Belarus-Russia gas transit dispute of December, 2006 and oil transit dispute in 2010; the Russo-Ukraine transit dispute in 2006 and 2009; the Moldova transit dispute in 2006;

does not mean transit states have no obligation under international law. They do. Those rules are coined in the MFN treatment obligation enshrined in the WTO and ECT, as well as universally internalised in bilateral and plurilateral treaties. Such obligations have been said to have the character of negative obligation - '*obligation to abstain from interference with transit*' or positive obligation - '*obligation to facilitate transit*'.[635]

Pipeline owners could also attempt to require the transit country to fulfil some volume obligation to destination markets which the transit country may perceive to be in excess of the transit fee. Worse still, they could even arbitrarily shut down pipeline stations in a transit state due to disputes over terms of transit fees. This was the situation with the Baku-Novorossiisk oil pipeline between Transneft, the Russian oil pipeline monopoly and SOCAR, the State Oil Company of Azerbaijan (the transit country) in a dispute over transit fees in relation to the quantity of gas agreed to be shipped by SOCAR, leading to Russia terminating the transit agreement in May 2013 and even shutting down the Aizebaijan section of the pipeline.[636] Another case is the proposed pipeline routes from Algeria to Italy and Spain posed significant technical and investment challenges with transit countries Morocco and Tunisia.[637]

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[635] For a comprehensive analysis of the scope and content of obligations of transit states, see Azaria, D., *Treaties on Transit of Energy via Pipelines and Countermeasures* (Oxford University Press, Oxford, UK) 2015, at 59-136. The author discusses transit states obligations under the GATT and ECT provisions, and within bilateral treaties in their application of the VCLT on the premise that even transit states can be parties to such treaties. It also employs international case law decisions in their interpretations of the relevant GATT and ECT provisions (78-94).

[636]*Russian Pipeline Monopoly Sets Low Transit Fee for Azerbaijan'* Available at http://sputniknews.com/business/20140225/187856055.html#ixzz3aRfkRNnA (Last visited 2 May, 2015)

[637] Bassam Fattouh and Jonathan P. Stern, *Natural Gas Markets in the Middle East and North Africa* (England Oxford, Oxford University Press, 2011) at 94.

Historically, transit pipelines have been unilaterally shut down by the owning governments over transit fee disputes with transit countries.[638]

5.10.3.1 Transit fees and 'tariffs' under GATT

Transit fees, otherwise known as tariffs in the WTO nomenclature, is simply some form of inevitable payment made by the pipeline entity to the transit country. Transit fees go through a bargaining process usually before construction (the negotiation period), during the pipeline construction, and after the completion of the pipeline (renegotiations). And as the pipeline project progresses from negotiation, construction, all the way to completion, the obsolescing bargain power normally shifts from the consortium to the transit country especially as the project would either be of no value without the transit country or be more expensive through an alternative route.[639] This makes the transit country strategic to pipelines.

In the GATT terms, Article XI:1 makes transit fees (tariffs) perfectly legal. It expressly prohibits every measure affecting international (cross border) trade except *duties, taxes or other charges.* These measures are in generic terms, tariffs (or charges), thereby allowable under Article XI:1. Since the GATT does not place a limit on tariffs, except instances where the limits are set out in the terms of accession to the WTO as in the case of China, then even randomly high transit fees do not necessarily give rise to a breach of the GATT provided (a) the transit state does not violate the MFN Treatment under

[638] The Kirkuk-Tripoli oil pipeline which was the first transit oil pipeline in the world was constructed in 1943 and designated to transport oil from Kirkuk in Iraq to Tripoli in Syria was closed by the Iraq petroleum company in 1982. The Trans Arabian petroleum pipeline (Tapline) traversing Jordan, Syria and Lebanon was constructed in 1950 but shut down in 1975.
[639] Omonbude, E.J., *supra* n 512 at 26. For the inception of the obsolescing bargain theory, See also Vernon, R., *Sovereignty at bay: The multinational spread of U.S. enterprises.* New York: Basic Books, 1971.

Article V:5 (b) they are not dues simply imposed on the transit, (c) they are non-discriminatory and reasonable charges for services rendered in relation to the transit pipeline, and (d) they may be in the form of necessary delays or restrictions. On the heel of this, transit fees of pure transit states, as well as political risks which do not in themselves constitute breach of a treaty, do not give rise to WTO disputes. The only thing to dispute about would be allocation of pipeline capacity. The fact that pipelines have varying capacities, as discussed above, poses a major challenge for transit.

5.10.4 Off-taker transit states

Unlike pure transit states, there is more at stake with the off-taking states in terms of measures directly affecting commodity, which becomes a trade effect issue. Off-taker transit states have economic interest not just in the form of transit fee, but in the form of lifting gas in transit to also satisfy domestic gas demands. They negotiate off-take agreements with the pipeline, and this development is believed to bring some stability to the free flow of commodity to markets. By their lifting interest, in addition to political risk, they also pose volume risks. In some instances, disputes arise where they lift more commodity than is allocated by the off-take agreement.

A case in point is the Russian gas to Western Europe transiting Ukraine as an off-taking State. Following a deteriorating relationship between Russia and Ukraine after signing a lifting Agreement in 2004 which priced Ukraine for future liftings, disputes arose over unpaid fees that was payable on the terms of the lifting agreement. Russia however, arbitrarily cut supplies to Ukraine for a few days in 2006 and again in 2009, thereby diverting gas supply away from the European market- a development that had serious repercussion for European markets.[640] Another instance was the transit pipeline dispute between Russia, and Ukraine also pose regulatory problems. There are also internal regulatory issues within the transit country that could change the trade dynamics of the pipeline especially in a situation of an integrated pipeline.

In an integrated gas pipeline whereby an off-taker transit country deregulates its gas market, the change in regulation that follows deregulation leads to change in the market structure and this in turn might have effects on the performance of take-or-pay obligations of the former gas monopoly in that transit country, thereby disrupting the performance of the pipeline implementation arrangement. This in turn would have a ripple effect on capacity arrangements under the gas transportation contract entirely. [641]

This overhauling of the transit country section of the chain could result in disruption of the economic equilibrium of the project giving rise to a dispute between the pipeline company and the transit country.[642] More so, such developments lead to change in bargaining power, and such shifts in bargaining power pre completion, at completion, and post completion of the pipeline will almost certainly have trade effects.[643] However, because off-taking countries have volume interest, they are less likely to invoke their bargaining power post completion that could disrupt the trade flow of the project than a non-off-taking country would.

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[640] See Stevens, P., 'Transit Troubles: Pipelines as a source of Conflicts' Chatham House Report, 2009, p. 9
[641] See Kolo, A., and Walde, T., 'Renegotiation and Contract Adaptation in International Investment Projects: Applicable Legal Principles and Industry Practices' (2000) 1 *Journal of World Investment* 5, 26-27
[642] *ibid*
[643] For a general understanding of the shift in bargaining power, i.e., the obsolescing bargain theory, See Pen, J., '*A General Theory of Bargaining*', The American Economic Review, Vol. 42. No.1 (1995); Muthoo, A., *Bargaining theory with applications*, (Cambridge University Press, Cambridge, 1999); Cross, J., *The Economics of Bargaining*, (New York basic books, New York, 1969)

Because transit pipelines traverse a third party country, there is the problem of regulatory asymmetry. As a result, there is hardly a specific national legislation and international legal and regulatory framework for transit pipelines, especially in developing countries. Therefore, they rely on terms of the pipeline contract [644]and on treaties governing the pipelines.[645] Hence, besides the above transit country measures, another regulatory instrument is the Stabilization clause in the Host Government Agreement between the pipeline company and the host States.

5.10.5 Regulation of transit obligation and the GATT/ECT relationship

A discussion on this sub head has been discussed in more categorical detail in Chapter 2 (2.5.2.1). However, it is imperative to state that the 'freedom of transit' principle under the more specific Article 7 (1), (2) and (5) of the ECT are adjudged not to have guaranteed absolute fortification against arbitrary interruptions and rent squeezing by transit states.[646] And if anything, Article 8 (1) of the draft Transit Protocol, in the fashion of the sovereignty principle, actually recognises the right of the transit country to cease or prohibit negotiations with countries with which it has unfavourable diplomatic relations.[647]

Moreover, even the terminologies such as the requirement of 'reasonable', 'transparent', objective', and 'non-discriminatory' suggests a standard of 'good faith' rather than 'command' or 'obligation' to which members states are requested to exercise when

[644] Both the International Government Agreement (IGA) and the Host Government Agreement (HGA)
[645] For instance, the Energy Charter Treaty provisions.
[646] Omonbude, E.J., 'Cross-border Oil and Gas Pipelines and the role of the Transit Country: Economics, Challenges and Solutions (Palgrave Macmillian, London, UK, 2013) pp 112-114
[647] *ibid*

shaping their measures.[648] And these provisions have been regarded as 'vague' in the context of the realities posed by transit states.[649] Of course, national sovereignty over energy resources is a core principle of the treaty, and that also applies to sovereign transit states.[650] And summarily, it has been admitted by the Energy Charter Secretariat that that ECT and the transit Protocol are incapable of preventing transit renegotiations and interruptions by non-off-taking transit with greater bargaining power post completion of the pipeline project.

5.11 Dispute Resolution and Enforcement competence

Disputes may arise from three channels. First, from the refusal of entry and the abuse of dominant position; secondly, disputes arising from the violation of GSA and/or GTA; and disputes from transit situations. Meanwhile, unlike with oil where there is no designated dispute resolution body created by any of the regimes, the EC single market have its own legally designate dispute resolution mechanism in the event of dispute arising from a State measure refusing entry to a new entrant.[651] So far, there is no recorded dispute settlement on gas issues in the WTO Dispute Settlement Body. Perhaps, it is either due to the fact that both the ECT and the Gas Directive makes provisions for settlement of disputes. This is not to say it is not feasible in the near future. But as is stands, such possibility may take a while to materialize.

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[648] Article 7 (para 3 and 4) of the ECT and Article 11 of the Draft Protocol.
[649] Omonbude, *supra*
[650] Article 18 of the ECT
[651] Art. 25 (5) G-directive makes provision for complaints against a TSO or a DSO to be referred to the regulatory authority instituted by member states to facilitate competition, who will act as a dispute settlement authority and issue decisions within two months, or longer if the complainant consents and upon additional information provided to the regulatory authority. More so, its appeal procedure is also provided for in Art. 25 (6) and 4 (3) G-directive, and the decision of the regulatory authority is binding.

6

Concluding Remarks

6.1 In a Nutshell

Revisiting the trade in energy jurisprudence, this research took a retrospective and audacious look at regulation of quota measures and trade-related investment measures operative in the oil sector and even more daring, in the gas sector, and how such regulation can be operative under or *in tandem* with the multilateral trading rules in an energy world that is typically shaped by complex multipolar regimes. This study applied an eclectic methodology encompassing: the legal theories of conflict of norms; the attribution doctrine; the essential facilities doctrine, and the 'mandatory versus discretionary legislation' doctrine, in arriving at some vital findings that enriches the 'WTO and Energy' literature as follows:

(1) There can be no meaningful answer to this question of a possible co-existence between the WTO rules applicable to energy and the resource-focused regimes in a multipolar energy world without first distinguishing regulation of trade and trade-related investment in oil markets from how such regulation work in the natural gas sector. Undoubtedly, these two sectors have very distinct physical, legal, regulatory, and policy features such that a generic approach to 'energy' which has been typical when discussing energy trade is rather simplistic. Addressing them in the context of their individual relationships with the GATT and the TRIMs Agreement is more onerous and eclectic but is a worthy pathway to any credible answer to the question of whether the international trade rules can grapple with the intrigues within energy regulatory systems.

2) In the oil sector, notwithstanding the extensive literature on border measures such as the status of production restriction, export restrictions through border tax adjustments for environmental goals, subsidies on petroleum products, and technical regulations in the WTO, internal (or behind the border) measures such as local content requirements, acreage allocation, divestment of majority ownership to local subsidiaries; and work commitment obligation, have largely defined the oil industry. More so, today, they have become the new face of the oil industry. The challenge however has been to designate these measures as TRIMs to justify a discussion under WTO law.

In finding that these measures sufficiently possess characteristics of TRIMs due to their direct influence on investments which ultimately affect export quota, I submit at this point that there may be room for a dissenting view. A possible ground for any dissention would be that these measures, unlike quota measures, are contractual in nature rather than policy; and that it may not be enough to say they have trade effect, but rather their characteristics must reflect local content requirements within the meaning of the TRIMS Agreement and Article III:4 GATT for them to come under the WTO scope. Admittedly, as it is today, that is not clearly the case. In essence, while there is justification for the WTO's competence in the oil sector on the quota measure side, such justification may be limited in the TRIMs side since TRIMs are designed for domestic consumption and not commercial resale. However, in view of the national treatment element of TRIMs, the designation of local content measures and acreage allocation, acreage allocation, divestment of majority ownership to local subsidiaries; and work commitment obligation as TRIMs within the meaning of the GATT Article III:4 and the TRIMS

Agreement is no due for discuss under the multilateral trading system in spite of their contractual nature involving non-stat entities.

3) Identifying TRIMs in the gas sector is yet a much more extraordinary journey in the field of energy and the WTO. Besides bulk transfers, the whole dynamics of moving gas from point A to point B with the underlying divergent players within the gas chain is principally hinged on not just the regulatory framework but also a function of network undertakings which unlike NOCs in the oil sector are non-State actors. Understandably, designating acts of such non-state actors as TRIMs for the purpose of implying state responsibility is a risky assumption. Although each state runs its own NRA, the control of investments in pipelines is arguably a subtle monopoly of pipeline undertakings. For trade dispute purposes, resolution of gas trade disputes tends to lie with UNCITRAL Model Law, ICSID, LCIA, and not the WTO. However, in addition to the effects access to gas pipelines gas commodity have in export markets (the trade effect), the essential facilities doctrine triggers more scrutiny within the WTO regime on the grounds of surrounding violation of competition law.

6.2 The Four doctrines in retrospect

A holistic approach to developing the 'Energy and WTO' literature has necessitated an diverse scrutiny of the theories of conflict of norms, the state attribution doctrine, the essential facilities doctrine, and the mandatory versus discretionary legislation' doctrine which this research presents as a contribution to literature in this area of jurisprudence. Undoubtedly, the complexity that accompanies equal competences of regimes having diverse objectives over the same subject matter (energy) makes the principles on conflict of norms all the more imperative. And since normative conflicts in this sense involves the interactions between interactions between states, state entities, and non-state actors, the attribution doctrine was not just relevant but indispensable. Nonetheless, its application in the energy sector, especially the gas sector[652] is visibly inchoate as there are no clear precedent or unanimous interpretation of state responsibility under customary international law in relation to which conduct of privately-owned monopolies, in particularly when controlling a "natural monopoly" in the form of energy transportation/ distribution networks, is to be attributed to the state.[653] Normally, this would mean Article XVII of the GATT on State Trading Enterprises is not appropriate in this pipeline transport regime.

But Waelde's suggestion that unlike with state trading enterprises where the attribution doctrine may infer strict liability on states, state attribution may not be completely plausible in such circumstances involving non-state actors, but a responsibility of "due diligence" modified into a "duty of fair and reasonable regulation of the economic conducts of non-state actors" should still be attributed to states clearly broadens the state attribution doctrine beyond its 'strict liability' narrative.[654] Accordingly, the attribution doctrine becomes justifiable in pipeline gas trade regime on the basis that EU States are tasked with ensuring TPA and overseeing justifications for any restrictions on TPA under *Article 21(1) of the Gas Directive,* thereby making them *de facto* custodians of TPA restrictions. And the argument that the dominant pipeline entities have to be state

[652] One thing we often see when the WTO and energy trade is discussed is that, gas is scarcely in the equation. This research changes that with both the attribution doctrine and the essential facilities doctrine.
[653] Waelde, T., *State Responsibility for subnational authorities and non-state national entities',* 27 Netherlands Yearbook of International Law (1996) at 143-194
[654] *ibid*

trading entities for the doctrine to apply has been weakened by Article 22 (4) of the ECT invoking state responsibility for the conduct of "any" entity operating within its territory.

This conclusion gives further attention to the essential facilities doctrine as even more persuasive in the pipeline gas sector on the basis that dominant pipeline undertakings even though not state entities, are actors influencing the regulation of third party access which ultimately determine flow of gas commodity. While this does not particularly imply states attribution, it triggers the violation of competition law within state territories. Access to pipelines under the single gas market regime is about market access and it is expected that sovereign states be the ones to ensure the non-violation of market access principles within their territories. Therefore, a combination of States' mandate under *Article 21(1) of the Gas Directive* and violation of competition by abuse of dominant position is clearly sufficient to bring gas within the WTO scope.

David Luff's position on this has so far been the closest to an acknowledgement of the linkage between competition law in the internal gas market and the WTO. To recount his remark, *"in the EC, the rules of the WTO may help entrants and the Commission to enforce market access and competition principles within the internal market…despite the lack of international competition rules, in sectors open to international trade which may still be subject to domestic monopolies, international trade law can be used to foster the adoption in domestic* *markets of certain principles of competition or liberalization procedures necessary to impede that market access or equal conditions of competition are impaired by these monopolies"*[655]

An unveiling of the corporate veil of NOCs on the other hand underscores their underlying influence as state vehicles in facilitating petroleum policy especially in developing producing states. By this, their acts should be designated 'state measures' under the attribution doctrine. IOCs as non-state actors also influence policy. But unlike with NOCs, their engagements would not normally be scrutinized using the attribution doctrine on the grounds that they are not state-owned entities. To reiterate R.J Dupuy's commentary, "*States alone can be parties to a treaty and that any agreement between States and a non-state party are 'instruments of another nature'.*[656] In this circumstance, the parties would normally be bound by international investment contract and their disputes settled by arbitration.[657] The only way to bring such agreements within the WTO frame is to determine that they have trade effects and so, breach arising therefrom could, alongside breach of investment law, be designated a breach of international trade law. There is no clear justification for this latter position though.

Lastly, 'mandatory versus discretionary legislation' principle was employed to answer the question of whether a regulatory measure in the gas industry, which is mandatory but arguably discretionary, can give rise to an action under the WTO which seeks mandatory compliance.

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[655] David Luff, '*Multilateral Trade Issues and Liberalization: Current and Future Perspectives*' in Geradin Damien (ed) '*The liberalization of state monopolies in the European union and beyond',* (Kluwer Law International, the Hague, London, Boston, 2000) at 334

[656]*Texaco v. Libyan Arab Republic* (1977) 41, 474, para.66.

[657] The core issue though in the case was whether a reference to general principles of law in the International arbitration context can this be held to be a sufficient criterion for the internationalization of a contract.

Even with cross-border transfers, commercial risk in pipeline investments arising from transit countries' disruption of the financial bottomline of transit pipelines adds more complexity to gas trade. This poses a problem for the multilateral trading regime whereby a transit country is a WTO member State but not a member State of the ECT. The WTO would have to invoke the ECT to give any meaning decision since the GATT is not robust enough since the plenary provisions of Article 7 of the ECT on freedom of transit via energy infrastructure better captures energy transit issues than Article V of the GATT.

6.3 The right to Regulate

The question of who regulates is crucial to both the attribution and essential facilities doctrines. The term 'regulation' has wide range of usage, but this research uses the term 'energy regulation' in the context of governments' direct energy policy such as licensing, local content requirements, price controls, export restrictions, etc.; treaty instruments such as OPEC's directive on production levels; acts of non-State actors such as NOCs; and pipeline undertakings controlling third party access to pipeline networks all of which can have trade effect, hence capable of being attributable to States. In essence, what is clear is that all of these measure emanates from the state – either by its own laws or its affiliation to regimes requiring compliance or regulating its behaviour.

Even with bulk transfers via LNG where trade in spot gas is largely present, like in the US for instance, the Federal Energy Regulatory Commission (FERC) was canvassed to be involved in LNG import process.[658] Also in the US, where private ownership of mineral estate rights and surface estate rights are rife, the question of who regulates those rights from the standpoint of the Texas Constitution and the United States Constitution has been settled by case law. The Texas Constitution grants all legislative powers to the legislature subject only to constitutional limitations contained in federal law.[659]

Generally, while regulation in the US is according to Selznick[660] characterised by a public agency's sustained and focused control over activities that are generally regarded as desirable to society, which involves not just passing laws but 'requires intimate involvement' with the regulated activity, regulation in Europe is viewed from the perspective of market ideology.[661] This explains the evolution of regulatory reform in the European Community with liberalization ideals and the power of market forces. However, Selznick was quick to point out that neither in the US nor in Europe has deregulation meant an end to regulation, but rather could mean less restrictive or rigid regulation.[662]

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[658] It was observed that even though the FERC operated as an independent commission within the Department of Energy, its involvement in LNG imports/exports was without complete independence. See Fox, W.F., *Federal Regulation of Energy* (McGraw-Hill, Colorado, 1983) p. 520-523. It was observed that even though the FERC operated as an independent commission within the Department of Energy, its involvement in LNG imports/exports was without complete independence.

[659] *Brown v. City of Galveston* 75 S.W. 488 (Tex. 1903); *Ferguson v. Wilcox* 28 S.W.2d, 526 (Tex. 1930). For instance, Article 10, Section 2 of the Texas Constitution creates the Railway Commission to regulate exploration, production, and transportation of oil and natural gas in Texas and allows the state to delegate its power to municipalities to reasonably regulate oil and gas production within their limits. See *Klepak V., Humble Oil & Refining Co.,* 177 S.W. 2d 215 (CA 1944)

[660] Selznick, P., 'Focusing organizational research on regulation' *in* Roger J. Nell (ed.) *Regulatory Policy and the Social Sciences* (Berkerley and Los Angeles: University of California Press) at 363-4, cited in Giandomenico, M., (ed.) *Deregulation or Re-Regulation?: regulatory Reform in Europe and the United States* (London: Pinter Publishers) at 1-2

[661] Giandomenico, M., (ed.) *ibid* at 2-3

[662] *ibid*

6.4 Possible future of jurisprudence on border measures and TRIMS in oil and gas

Currently, there are only two known WTO cases involving petroleum and none of them is petroleum as crude oil relating to resource access, but rather- petroleum products relating to market access – namely *US–Taxes on Petroleum* and *US-Gasoline*.[663] Disputes in relation to export-related measures (export quotas) in natural resources have not involved petroleum but raw materials – namely the *China-Raw Materials* and cases respectively.[664] Even WTO's progress in TRIMs cases involving energy and natural resources has not involved oil or natural gas so far, but rather renewable energy with the *Canada-Renewable Energy* case.[665] And in spite of the WTO's inclination to market access issues, even though the challenges of access in the gas sector is mainly about market access, there is no recorded market access case in the WTO relating to natural gas.

This lack of challenge to border measures and TRIMs in oil and gas is not proof of a global acceptance of the status quo, but a reflection of an awareness that challenging them before the WTO will be futile, as the US learnt from its failed attempts at bringing OPEC production restriction before the WTO Dispute settlement body. However, the

[663]*United States – Taxes on Petroleum and Certain Imported Substances* panel report adopted 17 June 1987, BISD 34S/136; and *United States – Standards for Reformulated and Conventional Gasoline*, panel report circulated 20 May 1996, adopted 20 May 1996, WT/DS2/R, Appellate Body report circulated 29 April 1996, adopted 20 May 1996, WT/DS2/AB/R (US – Gasoline)

[664] *China- Measures Related to the Exportation of Various Raw Materials* Report of the panel, 5 July 2011, WT/DS394/R, WT/DS395/R, and WT/DS398/R; Appellate Body, 30 January, 2012.
China – Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum, WT/DS431/R, WT/DS432/R, and WT/DS433/R adopted 26 March, 2014

[665] *Canada- Certain Measures Affecting The Renewable Energy Generation Sector,* Appellate Body, 19 December 2012, WT/DS412/R, WT/DS426/R

recent ruling of the Appellate Body in *Canada-Renewable Energy* have changed the mood and injected a new sense of hope for net importing developed countries.

Although that case is not about oil or gas, the finding that LCR is WTO-inconsistent is particularly instructive considering that LCR in the oil sector is gaining foothold across developing producing countries. The finding is believed to have created an opening for potential judicial scrutiny of LCRs in the energy sector amongst others such as mining, car-making and telecommunications, thereby widening the WTO jurisprudence in energy dispute settlement in the near future.[666] However, it has been suggested that while regulation of 'behind the border' TRIM policies under the WTO through an expansion of the WTO rules to cover investment incentives or FDI competition is instructive, it would be difficult to impose sanctions under the WTO dispute resolution regime for breach of such rules. And that just like the GPA, a plurilateral regime regulating performance requirements (including TRIMs) rather than a mandatory multilateral regime would be more effective.[667]

6.5 <u>On the prospect of a 'global energy governance'</u>

A global energy governance would require a regime capable of governing both the oil and gas sector in the same measure since the oil and gas sector forms the most part of the energy industry. Therefore, I do not find any feasible prospect for a 'global energy

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[666] Reuters '*Canada loses appeal in renewable energy case*' http://www.reuters.com/article/2013/05/06/us-wto-idUSBRE9450HA20130506 (Last visited June 5, 2014)
[667] Collins, D., *supra n* 355 at 230

governance' since the only multilateral treaty with global membership (the WTO) does not seem capable of governing both in the same measure as observed above.

6.6 <u>The 'cooperative energy governance' option</u>

A 'co-operative energy governance' looks more feasible since it does not require a unitary system which is quite elusive as far as oil and gas governance is concerned. Rather than forcing an evasive unitary system, bringing each regime to internalize the tenets of one another in ways that complement each other, much like how the ECT internalizes the GATT principles, is more futuristic. This would however require a frank acknowledgment of their divergent competence. While cooperation may not seem appealing to OPEC member states or producing States in general, developments like increase in non-OPEC oil production especially the US as a long time importing country; on-going accession negotiations to the WTO by the remaining world major energy exporters i.e., Iran, Iraq, and Libya; and falling investment in oil & gas may force cooperation. Also, other factors could see potential for the WTO's inroad in the energy sector such as: US' lifting of its policy on Export Ban in crude oil; Emergence of local content legislations in the oil and gas sector across developing countries especially in South America and Africa; and the recent WTO case relating to energy: i.e., decision on *Canada – Renewable Energy* in relation to the WTO inconsistency of local content requirement.

<u>Will OPEC and the WTO shake hands someday?</u>

OPEC's influence is currently being threatened by the in the global oil production mix. But in spite of the rising belief that OPEC's days are numbered due to expansion of non-

OPEC oil producing States, trend shows otherwise. And as long as OPEC is not a sovereign country, bringing a claim against OPEC before the WTO will remain a pipe dream.[668] Moreover, diversification of member states' economy from oil is hardly in their economic agenda so their policies on direct price setting,[669] production increase, or production restriction are designed to keep oil relevant. And as long as oil remains relevant, it would be inconceivable for OPEC member states to put crude oil trade on the negotiation table at any future GATT negotiations. But considering the growing developments in the oil market identified in this research as well as the current observer status OPEC has with the WTO,[670] which OPEC had applied for, the case for a cooperative energy governance between OPEC and the rest of the world remains authoritative – albeit difficult to accomplish.

Because international oil governance is vastly polarised, regulation will require cooperation amongst OPEC, non-OPEC oil producing States, oil producing State in their individual capacity (whether OPEC member states or not), and net importing states. And since oil markets is not linked by pipelines traversing regional territories, cooperation will be harder to achieve. Hence, while the WTO grapples with regulating gas markets because of its network structure, and with the ECT offering a more robust solution to trade via pipeline infrastructure, it grapples with regulating oil measures because of the fragmentation of oil regimes.

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[668] Only recently in 2013, OPEC decided to maintain its quota of 30 million bpd as a collective decision.
[669] OPEC used direct price setting from 1973-1982. See Roberto Mabro, *OPEC and the price of Oil* (Oxford: Oxford Institute for Energy Studies, 1992)
[670] See WTO Doc. WT/CTE/6, 18th September 2000 on application to the WTO Committee on Trade and the Environment, and WTO Doc. WT/COMTD/3, 1oth October, 2001 on application to the WTO Committee on Trade and Development.

Cooperation may therefore have to include trading-off oil for gas where some oil producing OPEC member States may not just focus on revenue from oil in terms of money, but also in terms of gas import from major gas exporters like Qatar and Russia in exchange for their oil so as to develop their own gas to power industries towards industrialization. This would, to a degree, de-monetize oil without OPEC member States being at risk of revenue depletion in the wake of increase in non-OPEC oil production and its accompanying price fall.

The WTO rules on energy needs fine tuning. To rectify its weaknesses in the oil sector, the GATT must either revisit Article XI:1, XX (g) and XVIII:2 in line with the development objectives and economic realities of developing and emerging market oil producing States (which it affirms in its Preamble) so as to meet the growing expectations in a changing energy world, or completely redefine its scope of rights and obligations regarding measures affecting oil export volume. The gas sector is too remote in terms of regulatory structures for the WTO to have inroads. It is be possible as the methodology have revealed, but it is a long shot at reality. It might be a question of "when?"

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